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THE PROBLEMS OF TOTAL WAR
AND
ROADS TO VICTORY

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
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PREFACE

ONE theme runs through these papers and discussions which constituted the program of the Sixty-third Annual Meeting of the Academy of Political Science, held at the Hotel Astor in New York City on November 10, 1943. Many problems of total war were considered—agricultural, industrial and financial—but a genuine unity was implicit in the recognition of the fact that the nature of the coming peace depends upon the way in which this war is won. What we do now, or fail to do, in resisting inflationary policies, in formulating a sound tax program, in handling the tangled threads of production, prices and wages, certainly will determine the course of our transition from war to peace.

If the " road to victory " is clearly marked on the military front, there are numerous alternative routes on the civilian front. In the hope that general public discussion may help us, as a nation, to choose wisely, the Academy presents this issue of its PROCEEDINGS.

It is appropriate to indicate here the Academy's appreciation of the contributions to this printed record made by the speakers and presiding officers at the various sessions. As is always the case, the success of the Annual Meeting should be attributed to the careful planning of the Committee on Program and Arrangements. Its members included: Frederick P. Keppel (Chairman),* Wesley C. Mitchell (Acting Chairman), Miss Ethel Warner (Director), W. Randolph Burgess, Nicholas Murray Butler, Frederic R. Coudert, Lewis W. Douglas, Leon Fraser, George L. Harrison, Pierre Jay, Thomas W. Lamont, Henry R. Luce, Charles Merz, Shepard Morgan, William L. Ransom, George Roberts, Alfred P. Sloan, Jr., George A. Sloan, Thomas J. Watson, Leo Wolman, Owen D. Young.

* Deceased.

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FISCAL POLICIES AND THE PROBLEM OF INFLATION

INTRODUCTION *

WILLIAM L. RANSOM, *Presiding*
Trustee of The Academy of Political Science

IT is my privilege to call to order this Annual Meeting of the Academy, in its sixty-third year.

I first express your regret, as well as my own, in the absence of Mr. Leffingwell, who was to preside. Mr. Leffingwell will be unable to be here. Therefore, while he would have been able to speak to you with authority upon the subject of this session, I shall not undertake to do more than to preside in his place and to present to you the distinguished speakers.

I do wish to remind you, however, that for many years the Academy of Political Science has been conducting these forums on topics which seem to be of paramount interest to the people of this country. Necessarily, these topics are selected by an expert committee long in advance. Usually, the choices have been fortunate, when the time came for making a contribution to an informed public opinion on a particular subject.

Today, regardless of rumors and hopes which may be rife, the Academy is intent on what is the paramount concern of us all—the problems of total war, economic, civil and military, as means of shortening and winning the war and overcoming the dislocations which it inflicts on all our lives. We hope and pray for victory and peace, but we are not diverted from the problems and tasks of total war.

I remind you that these papers and addresses, and such discussion as takes place within our limited time, are all published

* Opening remarks at the First Session of the Annual Meeting.

in our PROCEEDINGS, which become quickly available after the meeting, to members of the Academy and to others who subscribe for them.

The Academy of Political Science selects subjects and speakers; it takes responsibility for the timeliness of the subject and for the authority and right of the particular speakers to discuss the selected subjects. The Academy does not sponsor views, or select speakers because of their views, but because of their qualifications to speak on particular subjects.

This morning, as part of our program which goes through the afternoon and the evening, we are to discuss, as a sub-topic, American fiscal policies and the problem of inflation. I am sure that you all recognize this as one of the paramount issues at the present hour.

Our first speaker this morning was to have been our good friend, W. Randolph Burgess, Trustee of the Academy of Political Science and Vice-Chairman of the National City Bank of New York. Unfortunately, Mr. Burgess is unable to be here. Fortunately, his paper is here and will be presented to you.

You will recall that from 1920 to 1938, Mr. Burgess was connected with the Federal Reserve Bank of New York; that from 1936 to 1938, he was its Vice-President; that he had charge of its open market operations in government securities and of its activities as fiscal agent for the United States Treasury. Recently, he served as the efficient Chairman of the New York State War Finance Committee during the Third War Loan campaign, in which subscriptions by New York State individuals and corporations totaled nearly six billion dollars, which was about 30 per cent of the national total, as New York's contribution to that stage of financing the war. Mr. Burgess therefore is eminently qualified to write and to speak on "Inflation and Its Relation to Government Loan Campaigns". His carefully prepared paper for this meeting will be read by Mr. George Bassett Roberts, the son of a distinguished friend of the Academy for many years. I present to you Mr. Roberts, who will give you Mr. Burgess' paper!

[Mr. George Bassett Roberts read Mr. W. Randolph Burgess' prepared paper.]

INFLATION AND ITS RELATION TO GOVERNMENT LOAN CAMPAIGNS

W. RANDOLPH BURGESS
Vice-Chairman of the Board, National City Bank of New York
Trustee of The Academy of Political Science

IF we are to believe the official figures for the cost of living, the battle against inflation in this war has been relatively successful. The cost of living index number is only 26 per cent higher than it was when the war started in 1939. At that time certain types of agricultural prices were depressed, so that some increase in prices was not unwelcome. Indeed, some increase in prices in time of war is perhaps desirable as a stimulus to production; and surely a 26 per cent increase is not alarming.

A comparison with World War I is also rather cheerful. Between 1914 and December 1918 the cost of living increased by over 60 per cent, compared with a modest 26 per cent in this war.

Yet there is no satisfaction today over this situation. The Secretary of the Treasury, in his message to the Ways and Means Committee of the House on October 4, is greatly concerned about the danger of inflation, and says that not enough has been done about it. He computes the national income and the amount of goods available to be purchased, and concludes that after taxes there is a difference of some 42 billions of potentially dangerous dollars. He recommends a tax bill of 10½ billion dollars as necessary for at least a partial closing of the inflationary gap.

The Secretary of the Treasury is not the only one who is uneasy about the situation. All students of economics are worried about the huge increase in commercial bank deposits, which have more than doubled since 1939. Similarly the volume of currency in circulation has risen by some 170 per cent.

There are inflationary signs of other sorts. Wage payments are fabulous in amount. Amusement places are jammed. We

see on every hand the unmistakable evidence of excess spending power burning holes in people's pockets and escaping into the market in one way or another, and stocks of merchandise on the shelves of our stores have been rapidly declining.

All of this is very confusing. The cost of living figures say we have succeeded in restraining inflation and yet, under all the rules of the copybooks the symptoms of inflation are on us. We have all the feeling that the wolf is waiting around the next corner to pounce on Little Red Riding Hood and gulp her down.

The picture is in some measure simply an extension and grotesque enlargement of what happened during a considerable part of the nineteen-thirties, when the nation's budget was continuously unbalanced and bank credit greatly expanded. The economists and wise men of learning and experience knew that the goblins of inflation would get us if we didn't watch out. Then we did not watch out, but kept right on committing the inflationary sins—and the goblins did not get us.

For the present situation direct price and wage controls and rationing are partly responsible, but only partly. They do not explain the events of the thirties. The deeper explanation for all this seems to be rather simple, but one to which economists have given too little attention. Inflation is not a direct product of excess money; it is a product of human behavior. Money does not become wild by itself. It becomes dangerous only when it is used wildly by the people who have it; and the significant thing that is happening now is that, with some conspicuous exceptions, the financial behavior of the great bulk of our people has thus far been characterized by common sense. An extraordinary number of the human beings in this country who have been recipients of the newly created wealth have saved it instead of rushing off to spend it in some debauch of silk shirts or revelry by night. A very substantial number of our fellow citizens have used their money to repay debt, have bought life insurance policies, have increased their cash balances at the bank or in their pockets, or have bought government bonds.

The figures prepared by government agencies, while differing somewhat among themselves, and necessarily estimates, show a remarkable amount of savings. Both the S.E.C. and

Department of Commerce studies indicate individual savings this year of around $36 billions, with a cumulative total of around $80 billions or more for the four years 1940-43. This is far above the pre-war rate of savings, which until 1941 never exceeded $10 billions a year.

The largest type of savings is, according to S.E.C. calculations, in the form of idle cash balances in banks and currency, amounting in the four years to around $33 billions, and the next largest investments in securities — principally United States Governments—amounting to around $26 billions net. Growth of insurance and pension reserves accounts for $18 billions, and liquidation of consumer debt approximately $3 billions.

This behavior is in contrast with that of World War I. It appears from the limited data for the earlier period that there was certainly no such repayment of debt at that time. Instead debt was increased, especially as farmers bought more land. In both periods people did buy government bonds, though it seems clear that the bond buying is even more widely spread in World War II than in World War I, with at present well over fifty million holders of government bonds.

Our information in this field is admittedly sketchy, but the conclusion that the people have been more saving in their habits than we had reason to expect is supported by certain other evidence. It may be recalled that in the early thirties a vigorous effort was made to stimulate recovery by monetary methods, by pouring into the market huge amounts of funds and accumulating huge excess reserves in the banks. It was a method which had worked in the past, but it failed to stimulate recovery because velocity declined or, in plain English, people were conservative in their use of money.

A little later we tried the experiment of stimulating recovery with government spending, which had the effect of swelling the total of spendable funds, and again the results were disappointing. We poured money into people's pockets, but they refused to go on a binge.

Thus, what is happening today is a continuation of what has been happening during the past decade. We are reminded that in monetary theory the equation of exchange contains a factor called " velocity ", which we have all too often treated

as a constant. We are now given a demonstration that velocity is not constant but variable. Similarly, in the theories of the influence of government spending on business there is a factor called the "multiplier" which many economic treatises consider as a constant, but which, in reality, turns out to be a variable.

I do not know of any Gallup poll or other investigations which would shed light on this question of the behavior of human beings in spending or saving their money, but there are certain interesting suggestions which readily occur to one.

In the first place we are all still somewhat under the shadow of the deep depression of the early thirties. We all learned at that time so much about the wages of the sin of spending, and so much about the usefulness of a bit of reserve tucked away somewhere, that most of us have been a bit more conservative in our spending habits since that time. That is true of the business man and true of the private individual. In all this discussion we must not forget that business spending is one of the very important segments of total spending, and a prime factor in velocity and the multiplier.

Second, neither individuals nor business can today buy all the things they would like to buy. Automobiles, refrigerators, new homes, machinery, all of these and more, are high on the priority lists and unavailable for most of us. Normally these things absorb a substantial part of consumer and business spending.

Third, taxes have made us cautious spenders. While our actual tax rates on a given salary are still lower than the British, the rate of increase in our taxes has been greater, and in the face of that rapid climb in tax rates, conservatism in spending is encouraged. High rates also discourage the taking of risks.

In the fourth place we have been making a deliberate and on the whole successful effort to encourage savings through the sale of savings bonds. Fortunately this program started well before our entry into the war, and the methods and type of security have been well designed and perfected. Some twenty-seven million people are now saving regularly through the payroll savings plan, and the campaign which has brought this about has undoubtedly encouraged other savings as well. On

top of this we have now launched a series of war loan drives of a magnitude and breadth of appeal beyond anything heretofore attempted in this country.

The " drive " is in a sense a typically American mechanism. It suits the temper of our people for it combines drama, rapidity of action, and appeal to sentiment, as well as reason. These war bond drives are more than an effort to raise money. They are an opportunity to stimulate and renew the abiding loyalty of the American people to their country and to its ideals. They are one national enterprise in which there is no minority and in which there can be complete unity of feeling and action. In a country which has become very wealthy, which has been able to afford the luxury of bitter political disputes and the disorganizing gyrations of pressure groups, a unifying movement like our great war bond drives may have deep and lasting significance. They deserve the wholehearted and continued application of our best abilities.

Now let me try to summarize the somewhat intangible and perhaps confusing points I have tried to discuss. We face the paradox that the cost of living has shown a relatively moderate rise in the war, and yet, under all of the classic rules, we should be suffering from a severe inflation. The best single explanation of this curious situation seems to lie in human behavior. Our people are showing greater conservatism and caution in the use of the huge sums we have poured into their laps than we had reason to expect. When we seek the causes we run into a blind spot in economic thinking. Economics in recent years has made enormous progress in quantitative thinking; but here is a qualitative difference that is of vast importance and has been too much neglected.

One may indeed question whether in recent years, with our great progress in quantitative economics, we may not have slipped back to the hoary fallacy of the " economic man ", the picture of a mechanical world in which people are puppets moved hither and yon by intricate machinery of economic laws. Again and again we need to remind ourselves that economics is a science of human behavior, and must constantly study human psychology, how people actually do behave.

But, coming back to the present situation, does all this mean that we can sit back content with the situation and stop worry-

ing about inflation? Certainly not. We have noted that a substantial part of the savings which our people have accumulated in the past few years has been in currency and bank deposits; that is, they are in spendable form, and it needs only a change of mind about the future to put much of this money to work. The kindling has been laid for a wonderful inflation bonfire. We have been fortunate that nobody has yet lighted the match, and the size of the inflammable accumulation is steadily increasing.

Clearly we must continue and strengthen our efforts to see that the pile of inflation kindling is increased as little as possible from this point forward; that is, we should pursue as vigorous a tax program as is consistent with the maintenance of the efficiency and morale of the people. We must resist with greater fortitude the pressures for wage and price increases. We must sell as many bonds as possible outside the banks. We must find ways to limit government spending. But this is only part of the problem.

The other part of the program must be to pursue policies which will lead people to continue their saving tendencies, and that is a large order for it concerns the whole range of governmental and private action which determines people's motives. Their attitude will be influenced by tax policies and by the nature and effectiveness of the great bond campaigns. Everything we do which will decrease the risk of inflation will in itself encourage savings and operate in its turn as an anti-inflationary measure.

Also, may I suggest that the continued willingness of people to save is in part dependent on their conception of the future value of the money or the property which they save. That will be aided if we see to it that property rights in this country are protected. We save because we hope for the opportunities to use our money, pleasingly, profitably, and even adventurously.

But my one concluding thought must be that in this area we are dealing, not solely with a mechanical problem but also with a problem of human motives and the mainsprings of action. It is a political problem in the broadest sense, which we must not be content to leave solely in the hands of the politicians. On this front our hardest battles lie ahead.

REMARKS BY THE CHAIRMAN

CHAIRMAN RANSOM: The Academy is indebted to you, Mr. Roberts, for coming here to read to us so admirably Mr. Burgess' excellent paper, and for doing it at a time when you might have spoken in your own right.

Our second speaker of the morning comes to us from the law faculty of Columbia University, with which he has been identified since 1924. As his qualifications to speak on the subject of inflation and tax policies, I refer to the fact that he has served the Treasury of the United States at various times over a long period of years, and has been, among other things, the Under-Secretary of the Treasury in charge of tax matters. He has acted as adviser to the Tax Commission of Puerto Rico and to the Cuban Treasury, and has published many books and many articles on federal taxation and related subjects. We regard him as an authority upon the subject on which he is to speak, namely, " Inflation and Tax Policies ".

I have the pleasure of presenting Mr. Roswell Magill, Professor of Law at Columbia University and former Under-Secretary of the Treasury. Mr. Magill!

INFLATION AND TAX POLICIES

ROSWELL MAGILL
Professor of Law, Columbia University
Former Under-Secretary of the Treasury

WE have just witnessed the disheartening spectacle of a great financial committee of Congress refusing with singular unanimity to accept, either in whole or in part, the recommendations of the Treasury for tax legislation in time of war. The recommendations were undoubtedly preceded by careful and extensive studies by experienced men. They were apparently rejected in large part because they did not seem to embody the conclusions which the studies logically supported. The data were no doubt accurate, but the proposals were not very sound.

No unofficial person or agency can well assume the fiscal leadership which the Treasury lost. As citizens, we can, however, review the basic data, and come to an informed judgment on the best course to follow. In this country, the general opinion of intelligent people has a slow and implacable way of becoming the law of the land.

I

The general dimensions of the inflation problem are quite well known. The following data are drawn entirely from Treasury publications. The Treasury estimates that citizens will receive in the current fiscal year some $152 billions; and that available consumer goods will amount to about $89 billions.[1] On these figures there is an excess spending power of $63 billions. There are two ways in which it may be absorbed: by savings or by taxes.

Current savings are not readily estimated. The Treasury has developed estimates of $15 billions (based on the rate of saving in 1941) and $36 billions (based on actual savings for

[1] The Commerce Department reported on August 19, 1943, that national income, in the first six months of 1943, reached the annual rate of $143 billions, and that Americans would have $37 billions of 1943 income left after paying taxes.

April-June 1943). It is a fair guess that the true figure for 1943-1944 lies in between; perhaps the higher figure is closer to reality than the lower. Then, the Treasury finds that about $21 billions (probably an underestimate) will be absorbed by *personal* taxes, federal, state and local.[2] If, then, the higher figure for savings proved to be correct, the actual net inflationary gap would be about $6 billions, a sizable but not very alarming figure in relation to those with which we must deal. On the other hand, there is plenty of room for error in each of these estimates. Hence it is worth while to give further consideration to the three types of inflation controls.

Savings and taxes remove dangerous dollars before they can be spent, and turn them to the uses of the government. Government may also seek to control directly the expenditure of those dollars which remain in the consumer's hands. We have already adopted and are using various specific controls of spending. Rationing, price and wage control are being applied on a considerable scale, not apparently as rigorously as in Great Britain, but still with a good deal of breadth and effectiveness. One can still spend an increased income on a frivolous new hat or on a better suit of clothes; but one cannot buy a new car, or a new electric refrigerator, or a big new radio. There are not so many things on which one can splurge, save night clubs and amusements. (These seem to be doing very well, and are perhaps as good a drain as any to run off excess spending power.) The principal danger of consumers bidding against each other for a limited supply of goods seems to lie in the field of necessities of life; the area in which rationing is operating. We could certainly tighten up our rationing, price and wage controls, and administer them better. On the whole, improvements of this sort should be first on the list, for they are the most direct and therefore the most effective ways of insuring a fair distribution of a limited amount of goods among the population.

[2] The Treasury estimates gross collections of federal income and victory taxes (before the post-war credit on victory tax) for 1943-44 at $19.4 billions (*Hearings before the Committee on Ways and Means, Revenue Revision of 1943*, p. 30); and the net at $17.4 billions. Federal employment taxes in the total amount of $1.5 billions will be collected from individuals. It seems unlikely that all the kinds of state taxes individuals must pay out of income will amount to only $.1-2.1 billions.

Savings are the first great means of using up the excess of purchasing power over available goods. Our war bond campaigns have been directed at the individual, apparently with considerable success. We could increase the attractiveness of savings by providing a limited tax credit, not merely for purchases of government bonds, but for payments of life insurance premiums on new or old policies. Life insurance premiums are surely savings, and indeed are largely invested in government bonds. As a last resort, Congress might provide for compulsory savings, another name for higher taxes plus a post-war credit payable in bonds. The Treasury has opposed this step, since it would gravely prejudice the voluntary savings program.

We come finally to the last means available to absorb the excess dollars, which may produce inflation—taxation. Taxation has two major appeals, if one can be strong-minded enough to view it in the abstract. First, it provides a portion of the vitally necessary expenditures for war; and thus reduces by so much the burden which future generations must bear. Second, it takes away from the citizen dollars he otherwise might try to spend for the restricted stock of civilian goods. Further, by reducing by so much the amount which the Treasury must borrow, taxation reduces another stimulus of inflation—government borrowing from banks. Finally, as Walter Lippmann has pointed out, the threat of additional taxes—a very real threat in this country of one or two new tax bills a year—is a considerable curb on inflation.[3] The prudent among us feel that they must save to meet the stiffer taxes that lie just ahead.

Taxation has become an accepted means of discouraging, or of preventing entirely, transactions and activities deemed socially undesirable. A stock example is the federal tax upon oleomargarine, ¼ cent per pound if uncolored, 10 cents per pound if yellow in color.[4] If the tax is not too heavy, transactions will continue, as in the case of sales of uncolored oleomargarine; in that event, the tax will raise revenue, but will operate as a brake upon the transactions. If the tax is prohibi-

[3] *New York Herald Tribune*, October 7, 1943.

[4] Internal Revenue Code, Sec. 2301.

tively high, as in the case of colored oleomargine, the traffic will be completely stopped and no revenue will result. There are many examples of both types of taxes.[5]

The proposition that taxes should never be used as a means of social control, but only as a means of raising revenue, is pretty unrealistic in these times. The premise on which this proposition rests is that, since tax legislation is complicated in itself and complicated in its effects, legislators should try to confine its use to the simpler function of money raising. To be sure, it is not easy to forecast exactly what the effect of a tax will be. Moreover, taxes designed primarily to raise revenue, not to regulate, may have various social and economic effects, sometimes unintended by the legislators.[6] But since tax legislation can be an effective method of securing a desired result, why should it not be employed on occasion, as one of the various weapons in the legislative arsenal? The fact that a gun will destroy tanks should not prevent its use to liquidate a machine gun nest, if it will perform that task effectively. The tax bill should, of course, be subjected to the usual tests: (1) Is it apt to accomplish the desired purpose? (2) Will some other form of legislation better accomplish the desired ends?

II

Since the dollars we must drain off are those in the hands of individuals, increases in corporation taxes or in estate and gift taxes are of little use, however much revenue they may produce for the Treasury. To be sure, an increase in corporate taxes will reduce the amounts available for dividends, and so one item of individual incomes. On the other hand, increases in corporate taxes will also tend to increase the prices of commodities, and price increases are just what we wish to avoid. Estate and gift taxes do not have wide enough application to be serviceable for our purpose. Hence, while the Treasury's recommendations of an increase in the corporate income tax

[5] The many federal sales and excise taxes are examples of the first; the tax on white phosphorus matches, colored oleomargarine, and narcotics examples of the second.

[6] See Roswell Magill, *The Impact of Federal Taxes* (New York, 1943), ch. 3.

rate, applicable to net income in excess of $50,000, from 40 per cent to 50 per cent, and of a reduction in the estate tax exemption (from $60,000 to $40,000) and an increase in rates both of the estate and of the gift tax would certainly produce additional revenue, they would not aid materially in solving the inflation problem. The Ways and Means Committee has discarded both proposals, but has slightly increased the excess profits tax.

The principal other taxes in the federal system, which do affect individual spending power directly, are individual income taxes and the excise or sales taxes. These are the taxes which are best adapted to the present purpose. To determine what particular changes in the income tax should be made we need, first, the data which the Secretary of the Treasury gave early in his recent statement to the Ways and Means Committee:

> Today, four-fifths of all the income of the nation is going to people earning less than five thousand dollars a year. And except for the people earning no more than a bare subsistence wage, this group presents the greatest potential danger from the inflationary standpoint. The weight of the inflationary money in the hands of this group can cause undue price rises, and can completely upset our entire economic system, unless absorbed in sufficient quantity.[7]

In constructing a tax system for revenue purposes, the recent American way has been to adopt steeply progressive income tax rates. Thus, at present, the married man with a $2,000 gross income pays a $144 net tax, or 7.2 per cent of his income; the man with a $5,000 gross income pays $770, or 15.4 per cent of his income; and the man with a $100,000 gross income pays $59,753, or 59.8 per cent of his gross income. If we were drafting a tax bill for revenue purposes alone we would not consider placing the greater part of the burden, much less four-fifths of it, upon persons earning less than $5,000 a year.

Ability to pay is a much abused term; but, difficult as it is to levy taxes in proportion to ability, it is clear that ability to pay taxes increases progressively as income increases. Our present tax structure is a thoroughgoing recognition of this principle. In 1941 the official statistics of income show that more

[7] *Hearings*, p. 4.

than two-thirds of the income tax collections came from incomes in excess of $5,000 per year—that is, two-thirds of the income taxes came from persons with about one-fifth of the total income. But, as the Secretary points out, the dangerous dollars which we must control or take in additional taxes are predominantly in the hands of people earning less than $5,000. We are confronted with a different problem than the construction of an equitable tax system for revenue only. If new or additional taxes are to be used to aid materially in the solution of the problem of inflation, they must be collected principally from citizens who possess the bulk of the inflationary income. If the income tax is to be utilized for this purpose, the desired result might be accomplished by increasing the rate of the normal tax, applicable to all income, to 25 or 30 per cent.

To use income taxes in this way is not so unfair as it might seem. As already stated, more than two-thirds of federal income taxes rest upon persons with incomes over $5,000. No one proposes to lessen these taxes. The problem is: What additional taxes should be imposed to mitigate the likelihood of inflation? Moreover, an increase in the normal tax, though more burdensome to persons with small incomes, will necessarily also increase the taxes of those with higher incomes. The resulting tax system will still be one with steeply progressive rates, in which much larger portions of all incomes will be taken in taxes than has ever been the case before. For the past ten years, our tax system has moved steadily in the direction of greater reliance upon the progressive rate taxes, and of less reliance upon sales taxes. We should not really be turning the clock back if, to curb inflation, we increased the rate of normal tax generally applicable. Rather we should be adding a special tax for a special purpose to a revenue system generally organized on the basis of ability to pay.

But income taxes on persons with small incomes are hard to collect and to administer. They are not apt to be well understood by the taxpayer, and the tax forms may be a grievous burden to him. (Particularly is this true with that outlandish appendage to pay-as-you-go taxation — the advance estimate of anticipated earnings.) Withholding at the source is helpful, but it is no complete solution, unless the tax is collected on the basis of gross income without exemptions or de-

ductions. If there is some other fair way of collecting the necessary amounts from persons of incomes of all sizes, leaving the income tax applicable to persons with larger incomes, it might be a better choice than a sharply increased normal tax.

The sales or excise taxes are the last on our docket of possibilities. They fall roughly into two categories: taxes on various luxury or dispensable items—things any one of us could get along without—and taxes on articles which are necessaries or are widely used by all income classes. An expensive fur coat or a bottle of whisky is an example of the first kind of goods; gasoline, soft drinks or cigarettes are examples of the second category. Lines between the two are not always easy to draw. Some fur coats in some places are a necessity, some toilet preparations are necessities, some are luxuries of purest dye. Nevertheless, it would be generally agreed that in time of war, for revenue purposes, sales of luxuries, so far as we can define them, should be subject to stiff taxes. Moreover, aside from the inflation problem, these luxury taxes should be raised to a maximum, before a general sales tax is imposed.

Cigarettes, gasoline, soft drinks, chewing gum, matches, electric light bulbs and candy are not perquisites of the wealthy, yet sales of all of them are taxed today, and some very heavily. For ten years, we have imposed sales and excise taxes on a long list of commodities, varying with the needs of the budget, some of them luxuries, some necessities.[8] Tobacco taxes have been a mainstay of the federal treasury for generations. Why? The tax is comparatively easy to collect. It is paid by the consumer in small instalments, of which he is not in fact aware until he is told. The tax increases as use increases, and the consumer can always avoid the tax by stopping the use.

Suppose a general retail sales tax were imposed on all sales (except to the United States) without exemptions. It would strike more directly at the inflation problem than any form of income taxes, for purchased goods would cost just that much more. There would be another straightforward brake upon purchases. The consumer would realize, more directly than

[8] See, for example, *Hearings*, p. 31, for a list of various commodities and services upon which federal taxes are levied, and the yield of each.

with any other form of tax, that purchases were being discouraged. The tax would not be very difficult to administer, certainly not more difficult than an income tax designed to raise a similar amount from the same taxpaying group. It would not be unduly burdensome to pay, for the instalments would be comparatively small and would be currently collected. Finally, the tax would clearly affect persons with incomes under $5,000, as it would persons with incomes over $5,000. Since a greater part of small incomes than of larger incomes goes for consumption, and less can be saved, the tax would be more burdensome—would more effectively discourage spending by persons who have four-fifths of all income—than in the cases of persons with greater incomes.

This is the nub of the whole matter. Is a sales tax unfair, because it burdens the poor more heavily than the rich? Yes, certainly, *if it is the sole tax in the system.* Much of the discussion of the sales tax has gone off on this purely theoretical point. It is purely theoretical, for no one proposes that the sales tax shall be the sole tax in the tax structure. The question now is, what kind of tax would be the most effective means of curbing inflation? Personal income taxes at present are producing a gross return to the federal government (before the post-war credit) of nearly $20 billions, two-thirds of it collected from persons with incomes over $5,000.[9] The Treasury estimates that the sales tax at a 5 per cent rate would yield about $3 billions and at a 10 per cent rate would yield about $6 billions.[10] Much of this revenue also would be collected from persons with incomes over $5,000. In other words, even with the general sales tax added to the tax system for this special regulatory purpose, much the greater part of the burden of these two taxes would still rest upon persons with incomes over $5,000. Our tax structure would still consist for the most part of progressive rate taxes.

As a matter of fact our federal tax system is now more largely composed of taxes other than sales taxes, than the tax systems of the other great English-speaking countries. Great Britain, Canada and Australia each imposes either a general

[9] *Hearings*, p. 30.

[10] *Hearings*, p. 152.

sales tax in terms, or a sales tax on a wide range of specified goods. Our Treasury has concluded that, of our total taxes, 18.8 per cent are sales taxes, excises and customs. In Great Britain, the corresponding figure is 29.6 per cent; in Canada, 31.6 per cent; in Australia, 36.6 per cent. Even if the United States imposed a 10 per cent sales tax, the percentage figure of sales taxes, excises and customs to total revenues would merely approximate that of Great Britain. Of course, these other countries are not exactly comparable; for one thing, Great Britain relies upon an income tax stiffer in the lower brackets than our own. But the Treasury's data, showing the location of the dangerous dollars, the present operation of our tax system, and the composition of the wartime tax systems of other English-speaking countries all point to the desirability of the imposition of a general sales tax as the best form of tax to back up our rationing and price control regulations. Such a tax would produce substantial revenue—not, to be sure, anything like as much as the income tax, but nevertheless an important amount. It would not be nearly as difficult to collect effectively as an income tax on small incomes. It would be comparatively painless to pay. All citizens alike would have to bear it. We would do well to get away from the idea that one group of citizens only should pay for the war, another should be assured of exemption from these burdens.

The general sales tax, like the Ruml plan, has been the subject of heated debate, much of it beside the point. The tendency has been to discuss it either in terms of politics, or in terms of absolutes. The formulation of an adequate and fair tax structure in time of war can hardly be accomplished on either basis. When taxes could be low, the choice of taxes, rates and taxpayers was not so important. Now our taxpaying potentialities must be strained to the utmost. Fairness requires that all citizens with incomes in excess of a very modest minimum should pay in taxes for the war that is being fought for all of us. The fairness of a tax structure is to be determined by weighing the impact of the system as a whole, not by appraising single taxes without regard to the effect of the others. Such a determination is a very difficult job, requiring the exercise of the best judgment of experienced men—and even then opinions are bound to differ. Nevertheless on

the basis of the data at hand, it is reasonably clear that additional federal taxes should be imposed, to aid in the fight to control inflation; and that these taxes should take the form either of heavier normal income taxes, applicable to all persons with incomes in excess of the present modest exemptions; or of a retail sales tax, also generally applicable. The latter is better, because it can be more easily administered, will be less troublesome to taxpayers, and will strike more directly at the inflation problem.

With full recognition, then, that others will differ with me, as the Treasury already has, and that other conclusions may be better grounded, my own judgment would be that the following modifications in the federal tax structure should be made at once for the primary purpose of backing our price-control program: 1. Impose a general retail sales tax at a rate of 10 per cent. 2. Increase substantially the excise and sales taxes on luxury items. 3. Raise the income tax exemptions to $1,000 for a single person and $2,000 for a married couple, so that persons with less incomes than these would pay only the sales taxes.[11] 4. Grant a limited credit for income tax purposes for net annual savings, in whatever form.

Remarks by the Chairman

Chairman Ransom: Mr. Magill, I am sure the Academy is indebted to you for your thoughtful and very clear analysis of this timely and urgent subject.

Our discussion this morning turns next to the sphere of international finance and trade and the policies of the United States as a creditor nation. Our speaker is Dr. John H. Williams, Dean of the Graduate School of Public Administration at Harvard, Vice-President of the Federal Reserve Bank of New York, member of the Harvard faculty in economics since 1921, author of many books and magazine articles, with which many of you are familiar, in the field of international finance, currency and monetary problems. Today he will speak to us on "The Policies of the United States as a Creditor Nation". Dean Williams!

[11] See a fuller development of this recommendation in H. L. Lutz, "The Small Income and the Sales Tax", *The Tax Review*, October 1943.

POLICIES OF THE UNITED STATES AS A CREDITOR NATION

JOHN H. WILLIAMS
Dean, Graduate School of Public Administration, Harvard University

FOR the second time we are facing the problem of carrying over into peace the spirit of international coöperation developed in war. Last time our experience was very disappointing. It is a striking fact that the chief development in economic theory during the inter-war period was the closed economy analysis, and in economic policy one of the main developments was the movement in various countries toward self-sufficiency. Some people explain in psychological terms the wave of nationalism that so often follows war; war develops our pugnacity, and after we have rested a while we want to fight again. But the explanation goes much deeper. War profoundly changes international relationships and presents most difficult problems of readjustment.

In the last war the position of the United States was changed from a debtor to a creditor nation. Another great change was in the position of Germany, where economic exhaustion at home, the loss of foreign assets, and the reparation payments were major causes of the great post-war inflation. After this war the United States will be the only large creditor nation. Some younger countries, such as Canada and Argentina, which will also come out of the war in a creditor position, will probably in the longer run again become net capital-importing and interest-paying countries. The most striking change will be in the position of England; she will enter the post-war period as a debtor country after having been for more than a century the world's leading creditor.

England's post-war problem is highly complicated. She has lost the greater part of her foreign assets, and there is now an accumulation of sterling balances owed to foreign countries—quite apart from lend-lease transactions—which is estimated at four to five billion dollars and is growing at the rate of two billion dollars a year. England is worried about her future position in shipping and aviation. Her internal reconstruction

will require imports, particularly of raw materials and food products, while she is planning to coöperate with us in providing relief for other countries. At the same time, because of her debtor position, she will have the quite new problem of developing a large excess of exports. England will have an interest second to none in maximizing foreign trade by helping to restore a multilateral system of world trade. Even her previous ability as a net importing country to keep the upper hand in bilateral trade agreements will largely have been lost. But it seems likely that England will approach the task of international currency stabilization with a cautious attitude. Two main questions are: (1) whether any plan for currency stabilization will give her sufficient freedom both to find the equilibrium rate of exchange between her currency and others—always a major problem after a war—and to permit an orderly adjustment of rates thereafter as basic conditions change; and (2) how to reconcile the requirements of international currency stability with the maintenance of a high degree of control over her internal economy.

I cannot deal with the general problem of currency stabilization or the plans now under discussion between our Treasury experts and those of the British Treasury,[1] but my remarks today are concerned with one aspect of that problem. It is part of the tradition of the subject that the creditor country has a special responsibility for international monetary and trade relations. One of the reproaches running all through the inter-war period was that we did not play our rôle, and that in consequence the restoration of the gold standard in the nineteen-twenties led to intolerable deflationary pressures upon other countries and a new collapse. Rather than repeat that experience the debtor countries would prefer to take their chances with bilateral trade agreements and exchange controls, poor as they recognize this alternative to be. We owe it to ourselves and to them to survey the inter-war experience and the peculiarities of our present position.

Many of the worst features of the last post-war period had nothing to do with the normal relations between debtor and creditor countries. We ought this time to be able to avoid the wild gyrations of currencies that followed the last war. Prac-

[1] See my paper in *Foreign Affairs*, July 1943, and a forthcoming paper in the January issue.

tically all nations will come out of the war with effective systems of exchange control, and these should be relaxed only slowly and carefully. It seems not improbable that England will retain more permanently control over the short-time movements of capital resident in Britain, even though to do this she must retain the machinery of a general exchange control, and free trade movements from it by means of general licenses.[2] The main cause of the recurrent flights of capital between the two wars was the economic and political insecurity in Europe. If this can be removed we shall be in a better position to see how much control over capital movements is essential.

Two of the chief mistakes last time, reparation payments and inter-Allied debts, we must hope will not be repeated. I realize I cannot dispose of the reparations question as summarily as this. German confiscations of property in occupied countries will require restitution of national ownership, at least; Russia may demand, and be able economically to accept, payments in goods or in services; and there may be other possibilities; but surely the transfer problems which bedeviled the world in the nineteen-twenties will be avoided. One of our cleverest moves in this war was to think up lend-lease, and my only regret is that we did not at the time provide for its extension for perhaps three years after the peace, on the theory that the first phase of peace is but a projection of the war—war does not end when the shooting stops but when the difficult transition back to more normal international conditions has been achieved. A considerable part of the inter-Allied debt last time was incurred after the Armistice.[3]

The experiences of the twenties and thirties do not suggest that the rôle of a creditor country under post-war conditions is a simple one. We were condemned, probably more than for anything else, for our protectionist policy, and the criticism was deserved; but our policy was quite in line with that of

[2] I am not entirely sure, indeed, that England and some other countries will forswear all direct control over imports; when the choice is between this and changing exchange rates the answer is not clear a priori.

[3] Since the meeting of the Academy, Leon Fraser, at the *New York Herald Tribune* Forum, November 16, 1943, has suggested a "moratorium for a period of five years of any post-war lend-lease repayments involving transfers out of Great Britain, any repayments thereafter to be limited to the return to the creditor, of the same commodity as was shipped."

other countries demanding but unwilling really to accept the reparation payments. As a creditor nation we were expected to assist in restoring and maintaining international stability by exporting capital. The capital movements occurred, mainly to Germany and Latin America, but have generally been regarded since as disturbing rather than corrective factors. Especially significant was the controversy which developed after England's return to gold in 1925. The reproach that we were sterilizing gold and preventing the internal monetary expansion required by gold standard theory was quite unfounded; as we saw more clearly later, we were in the early stages of the expansion which led to the crash of 1929, though that was obscured by the fact that the rise was in security prices and in incomes rather than in commodity prices. Our attempt to push out gold in 1927 by lowering interest rates ended in failure, and is thought by many to have intensified the stock market boom. The chief mistake was in the overvaluation of the pound. It should make us more aware this time how important it is to find the equilibrium rates if currency stabilization is to be attempted with any prospect of success. Despite all that was written on the subject and the great interest developed in " purchasing power parities ", this seems to be mainly a trial-and-error process involving mutual consent and a flexible approach providing for orderly change in rates as the basic circumstances warrant. How to do this consistently with the general objective of exchange stability seems to be the essence of the problem; adequate discussion of it would go far beyond the limits of this paper.

There are some peculiarities of our creditor position which we ought to puzzle over ourselves and try to make clear to others. For this rôle we lack many of the advantages which England had in the nineteenth century. England was at the center of world trade and finance, sterling was the medium and the London discount market the clearing mechanism for international payment, and the Bank of England by its discount rate could greatly influence capital movements and the flow of gold. England had a unique position such as will probably never be enjoyed by any single country in the future. When reference is made, as occurs so often, to how well England performed her function as the creditor country, with the implication that now it is our turn to do as well, these differ-

ences must not, if we are to think clearly, be forgotten. The problem has become more difficult all round; and even then it was not simple or the performance very good much of the time. The nineteenth century was one of great economic progress but one marked by great world-wide depressions and by periodic breakdowns of the gold standard.

But all comparisons are relative, and the problem was simpler then than now. For England, once her industrial revolution had come to full development and found full expression in her trade and capital relations with the rest of the world, there could be no doubt of where her interests lay and no room for a divided national feeling about her commercial or financial policies. Rarely has there been a time, too, when what suited the creditor country so well suited many of her debtors. Though there always was a danger that international free trade theory too literally applied might interfere with the national development of countries less advanced, and conflicts on this point were never absent from our colonial period onward, the nineteenth century witnessed on the whole a harmony of trade and capital relationships which may never be seen again. Capital exports and interest payments were matched by manufactured exports from the lending country and food and raw material imports from the borrowing countries with cumulative advantages for both.[4]

One of our peculiarities is that we are still a mixed agricultural-industrial economy. When we talk of maximizing imports there is certain to be a divided national interest about what imports are involved. At an earlier stage when we were a great agricultural exporting nation and a young industrial nation, the emphasis was on protecting manufactures, and the conflict was between the industrial North and the agricultural South and West interested in expanding export markets and getting cheaper manufactures in exchange. Now it is agriculture, too, or perhaps mainly, that wants protection, and the day of an undivided national interest in commercial policy seems still far distant. I grant that this point can be overstressed, and I have often said that trade tends to be greatest among

[4] I have always felt that the full significance of this growth process was missed by the classical theory of international trade and the gold standard, which was essentially a static theory assuming full employment of known resources, and revolved too much around the "terms of trade".

countries of highest purchasing power, regardless of their special characteristics; but it remains a troublesome feature of our international situation, and may well have intensified effects on other countries after the war, when we shall have synthetic rubber and other new products formerly imported to think about.

Another of our peculiarities is that, though this country is the world's greatest reservoir of capital and will probably always be a net exporter of capital over any long period, it is probably also, under favorable conditions, still the greatest magnet for outside capital, for investment and speculation as well as for safety. In a boom we might easily shift from being a net exporter to being a net importer of capital, exerting deflationary pressure upon debtor countries, from which they could probably not find relief except by direct control of capital outflow. The late nineteen-twenties have been often cited as an illustration of this phenomenon, and the attraction of foreign capital into our stock market has been emphasized as one cause of the great depression.

I have been dwelling mainly upon the difficulties of our position rather than their solution, and I am afraid this fairly represents the present state of my thinking. I do, however, want to make some more positive suggestions. In the immediate post-war period the chief need will be for relief and rehabilitation.[5] This should be handled by free contributions, or under lend-lease. But there will also be a need for reconstruction in a broader sense, involving loans. Our Treasury published in October a tentative plan for an international bank, but it is difficult to see how there can be a truly international bank in a world composed of one large creditor and many debtor countries; however the bank is formally organized, the funds will have to come chiefly from this country. Relief and reconstruction will make heavy demands upon American production during the period of transition from war- to peacetime production. This demand for exports will come on top of a huge deferred demand here at home for producer and durable consumer goods, a demand backed by the great accumulation of unspent wartime incomes. We shall need to ration our

[5] Reports are now beginning to come out of the plans of the United Nations Relief and Rehabilitation Administration; they call for expenditures of two and a half billion dollars. See *New York Times*, November 16, 17, 1943.

production between home and foreign requirements and to maintain our direct controls, as well as fiscal and monetary controls. With the war ended, the task of persuading the public that these controls are necessary will probably be much more difficult than now. It is in this early post-war period that the danger of inflation will be greatest. If the war ends in Europe before it does in Asia, the difficulties of transition will be lessened; some expansion of peacetime production should now be planned, to take effect as soon as war in Europe ends.

Looking farther ahead, the world will need both our capital and our markets. How to bring both things about is something of a puzzle. Maximizing foreign trade all round will, of course, help all countries. But that may not be enough to right the great unbalance which will exist, and to meet the much greater needs of England and some other countries to expand their exports. This is another aspect of the fact that we are not yet a mature creditor country in the nineteenth-century British sense. England was a creditor on income account, with a net excess of imports. In our balance of payments, interest receivable is offset by tourist expenditures and foreign remittances, which will probably increase after the war; and when we add to these our capital exports we shall probably continue to have an excess of merchandise exports for a long period to come. To bring about a combination of exports of capital from this country accompanied by goods exports from other countries would seem to require something equivalent to a sustained one-way movement of gold from this country, accompanied by rising prices here relative to outside price levels, and even, as some writers suggest, by a continuing direct control over our exports. But it seems unlikely that such policies will be adopted. One service we could do to foreign countries would be to restrict our lending to the really necessary demand in the foreign country for foreign goods—producer goods and really essential consumer goods. Expenditures for domestic labor and resources should be financed at home. Often what is most needed is engineering or financial advice rather than a loan.

The greatest contribution we can make to world stability is by maintaining high production and employment here at home. This would maximize imports and create the most favorable conditions for reducing tariffs, though it probably would not, by itself, lessen exports. The advantages of a high level of

production are sometimes overstated to imply that international trade adjustment could be made a one-sided process of expansion in the high production country. If the expansion could go on indefinitely without danger of a boom this might be true, but in the post-war period, as I have said, this danger will be real. There is also the difficulty I mentioned earlier of reversal of the capital movement, and the feeding of expansion in the creditor country by deflationary pressure on the outside world. All in all, however, internal stability at a high level would be much our best contribution.

But this only shifts the emphasis to another problem no less difficult than international monetary and economic stabilization. It raises issues about methods on which public opinion is far from united; and government planning in the domestic field for the post-war period is probably less advanced today than in the international. One of the great unknowns, also, is what is to be the character of internal planning in other countries. In England, many recent utterances by political leaders and economists seem to foretell the retention of a much higher degree of internal control, not only for the period of transition to peace but more permanently, than England had before the war. How much of such control is compatible with international monetary stability and a multilateral trade system will be one of the chief problems of the post-war period.

Remarks by the Chairman

Chairman Ransom: We thank you, Dean Williams, for your interesting address on international angles of our subject.

Like Dean Williams, our next speaker also comes from Harvard University, where he is in the Graduate School of Business Administration. He is one of our recognized authorities on wages and labor relations as factors in the general business picture of America, and has won the respect of both management and labor unions for his fair-mindedness in the mediation and arbitration of labor disputes. Two years ago he was President of the American Economic Association. His subject this morning is " Inflation and Wages ", an angle which is so much in the minds of all of us at this time. Professor Sumner H. Slichter, Lamont University Professor of Economics at Harvard University!

INFLATION AND WAGES

SUMNER H. SLICHTER
Lamont University Professor, Harvard University

I

FOR the first time in American history payrolls this year will surpass $100 billion. Over 75 cents of every dollar paid out to individuals will go into payrolls, as compared with 9 cents going to property owners in the form of dividends, rent or interest, 9 cents going to farmers, and slightly more than 6 cents going to the self-employed. Since 1939, payrolls have more than doubled. During the same period, payments to nonagricultural property owners (dividends, interest payments and rents) have risen by 15 per cent.[1] The rise in payrolls has been 24 times as large as the rise in payments to property owners and has been four times as important as all other causes of larger incomes put together. Of the major economic groups in the community only the farmers have had a proportionately greater increase in income than wage-earners, and the average annual return of farmers is still little more than half that of factory workers.[2] Plainly if larger incomes threaten inflation, wages represent the heart of the problem.

Wages may mean either wage rates or payrolls. Hence in considering the relation of wages to inflation one must examine

[1] Payments of dividends, interest and rents were $11.2 billions in 1939, and will be about $12.9 billion in 1943. Actually property owners have fared better than the above figures indicate because undistributed profits of corporations which were $400 million in 1939 will be about $4 billion in 1943. Hence, the entire return to nonagricultural property owners has increased from about $11.6 billion in 1939 to $16.9 billion in 1943 or 45.7 per cent. This is less than half the rate at which payrolls have increased.

Four-fifths of the increase in income payments to individuals since 1939 is attributable to larger payrolls. In 1939, wages and salary payments were $44.2 billion. In 1943, they will be about $101 billion. The increase of $56.8 billion is 25 per cent more than the volume of payrolls in 1939. It is 79.3 per cent of the increase of $71.6 billion in income payments to individuals.

[2] In 1942, the average annual income of farm operators was $1,062 and the average annual income of employees of manufacturing enterprises was $2,043.

the significance of both wage rates and payrolls. What part have changes in wage rates or in payrolls played in creating the problem of inflation? Up to now the record of price control has been reasonably good. Although income payments have doubled since 1939, and the quantity of goods available for consumption is virtually the same in 1943 as in 1939, the index of the cost of living is up only one-fourth and the real cost by probably less than one-third.[3] What part has wage policy played in achieving this result? What problems are ahead? The unions are preparing a drive against the Little Steel formula. Is the national wage policy about to break down? If it does, will there be a dangerous and disorderly rise in prices? Should the national wage policy be altered or abandoned? If so, in what respects? What is likely to happen to payrolls and wage rates after the war? Is there need for a national wage policy after the war? If so, what should it be and how should it be implemented? These are the questions to which I invite your attention.

II

What has the rise in the price of labor had to do with the rise in commodity prices? Since 1939, straight-time hourly earnings in manufacturing, when corrected for the shift of workers from low-paying to high-paying industries, have gone up nearly 33 per cent and in fifteen nonmanufacturing industries by about 20 per cent.[4] These figures are considerably less

[3] The quantity of goods available for consumption in 1939 was $61.7 billion; in 1943, it will be about $62.6 billion in terms of 1939 dollars. In July 1943, the index of the cost of living was 24.7 per cent above the monthly average of 1939. Because of deterioration in quality not fully reflected in the index, the real cost of living was probably up about 30 per cent.

[4] In 1939, the monthly average of straight-time earnings of factory workers was 62.2 cents; in July 1943, 82.3 cents. In fifteen nonmanufacturing industries the increase in straight-time hourly earnings was from an average of 72.3 cents in 1939 to 86.2 cents in 1943, or 19.2 per cent. These figures probably represent the *change* in the wage level between 1939 and 1943 more accurately than they represent the wage level at either time. The fifteen industries are: anthracite coal, bituminous coal, building construction, dyeing and cleaning, electric railway and light, laundries, metal mining, petroleum products, quarrying, railways, retail trade, street railway and buses, telephone and telegraph, wholesale trade. The fifteen industries employed in 1939 almost 10 million workers.

than the currently published figures of the Bureau of Labor Statistics which are not corrected for either overtime or shifts.[5] The real change in the price of labor between 1939 and July 1943 was about 31 per cent for factory workers, 19 per cent for wage earners in fifteen nonmanufacturing industries, and probably about 15 per cent for other workers—an average of about 20.7 per cent.[6]

[5] According to the Bureau, hourly earnings in manufacturing in 1939 were 63.3 cents, and in July 1943, 96.3 cents, an increase of 52.1 per cent. Corrected to eliminate penalty overtime rates, hourly earnings in July 1943 were 90.3 cents. Hence the shift from low-paying into high-paying manufacturing raised straight-time hourly earnings by about eight cents—from 82.3 cents (see footnote 4) to 90.3 cents.

[6] This assumes a rise of 31 per cent among 8.2 million factory wage-earners, a rise of 19 per cent among the 10 million workers in the fifteen nonmanufacturing industries listed in footnote 4, and a slightly smaller rise of 15 per cent among 12 million other nonagricultural employees — factory white collar workers, government employees, employees in finance, domestic service, and others. The employment figures are as of 1939.

Neither changes in hourly earnings nor changes in wage rates are entirely satisfactory measures of changes in the price of labor. In a period of expanding employment, changes in hourly earnings, even when corrected for overtime, are likely to overstate changes in the price of labor because they are affected by a rising proportion of men who receive a shift differential for night work. Figures of wage rates almost invariably understate rises in the price of labor. Indeed, it is a common experience for the price of labor to rise even though wage rates remain unchanged. This happens because piece rates are not reduced to offset small improvements in equipment, raw materials, or working conditions which enable the workers to increase their earnings. Strictly speaking, such improvements represent increases in *both* the piece rate and the price of labor—despite the fact that the nominal piece rate remains unchanged. Cases of piece rates remaining unchanged in the face of important improvements in conditions of work have been very numerous in the last several years in the industries making new war products. Fictitious upgrading is another way in which the price of labor may be raised without wage rates being changed—men being hired as handy men or helpers at rates above the common labor rate, but used as common laborers, or hired as first-class mechanics when in fact they are nothing but specialists, second-class mechanics, or even helpers. There has been much fictitious upgrading in the last several years.

There are some types of changes in the structure of wage rates which are most conveniently expressed through changes in hourly earnings. For example, rates may remain unchanged, but the period of stepping up from the lowest to the top rate in each classification may be shortened. This has been happening on a large scale during the last several years. Street railway

During most of the period, retail prices and the wholesale prices of finished goods have risen sooner and faster than the price of labor.[7] This does not necessarily mean that changes in labor cost have had little influence upon price changes. When supplies are governed by costs, shifts in the supply curve or changes in its slope have just as real an influence upon prices as do shifts in the demand curve regardless of which shift occurs first. But in the past year or two have not supplies of civilian goods been limited by physical scarcities rather than by costs? For many commodities the answer is undoubtedly, "Yes." Nevertheless, the virtual disappearance of many cheap grades of goods from the markets and the small increase in working hours in the manufacturing of nondurable goods

and bus lines which have stepped men up gradually from the minimum to the maximum in five years have cut the time to two years or a year and a half.

A figure slightly below the figure for hourly earnings after correction for shifts and overtime seems to me to correspond closely to changes in the price of labor. The above estimates are made in this way.

[7] Even the great gain in the number and power of organized workers does not seem to have changed the customary relationship between the timing of price movements and wage movements. Possibly a separation of union and nonunion plants would show contrasting relationships between the timing of wage movements and price movements—although I hazard the guess that it would not.

The following table compares the changes in hourly earnings in manufacturing (corrected for overtime and the change in the distribution of workers) with changes in the prices of finished goods, retail prices, the cost of living year by year since 1939:

	Adjusted Hourly Earnings in Manufacturing	Finished Goods	Retail Prices	Cost of Living
		Percentage Increase		
Twelve months ending:				
January 1940	1.9	2.1	0.4	—0.2
1941	2.0	2.2	2.1	1.3
1942	12.5	15.4	18.8	11.1
1943	8.9	3.8	9.8	7.8
Six months ending:				
July 1943	3.7	0.5	3.0	2.6

Between 1939 and July 1943, adjusted hourly earnings in manufacturing increased approximately 32.3 per cent; finished goods 23.9 per cent; retail prices 35.3 per cent; and the cost of living 24.7 per cent.

above 40 a week indicates that costs are still important in restricting supplies. In July 1943, weekly working hours in the manufacture of nondurable goods were only 42.2. This low figure, however, suggests that the costs which limit supplies are the stiff penalty overtime rates rather than recent increases in regular wage rates.[8] Hence one reaches the conclusion that in so far as employers plan the volume of their output by the level of marginal costs, the supply of goods has been limited by previously established overtime penalties rather than by recent increases in the price of labor. In so far as current production plans are governed by *average* costs rather than marginal costs, recent increases in wages have been important in limiting the supply of goods and in helping to raise prices. Knowledge of how production plans are actually made is still too meager to permit informed judgments. My guess, however, is that on most nonwar production, overtime penalties have limited the supply of goods far more than recent increases in the price of labor.

III

What have rising payrolls had to do with the problem of inflation and what conditions are responsible for larger payrolls? I have already said that increases in payrolls since 1939 were four times as important as all other causes of larger incomes put together. Why have payrolls increased? Increases in wage rates have been far less responsible for larger payrolls than the public imagines. Had every wage rate in every plant in the United States been frozen in 1939, payrolls still would have doubled. Of the increase of nearly $57 billion in payrolls during the last four years, less than one-fourth, or about $13 billion, is attributable to the rise in the price of labor. The biggest source of increase has been more people at work. This accounts for over one-third of the rise or about $21.2 billion.[9] The next largest source of greater payrolls

[8] Although the rise in the price of labor affects overtime rates also, the original penalty of 50 per cent is so stiff as to make still higher costs of overtime of little practical importance in most instances.

[9] Of the increase in payrolls attributable to more employment, $13.8 billion is explained by increases in civilian employment and $8.6 billion by larger payrolls for the armed services.

has been the movement from low-paying to high-paying plants and industries. It accounts for $13.4 billion of the increase.[10] The opportunity which the war has given men to move into better paying jobs has been equivalent to a 33 per cent wage increase. About $7.1 billion of the increase in payrolls is explained by the longer working week and $2.1 billion by penalty overtime.

IV

This analysis shows that only a small part of the problem of inflation can be met by wage policy. It does not follow, however, that wage policy has been of negligible importance. Had the price of labor risen 75 or 100 per cent in four years, as it did in the first World War, the prices of finished goods and the cost of living would of necessity have risen in the same propor-

[10] War production has been in the main an expansion of manufacturing production, and annual earnings in manufacturing are higher on the average than earnings outside manufacturing. Within manufacturing, war production has been largely concentrated in the industries making machinery, transportation equipment, and other metal products. These industries, even before the war, paid higher wages than manufacturing as a whole.

In 1939, the average annual salary-wage per employee in manufacturing was $1,309, as compared with $1,284 for all nonagricultural industries. By 1942, the average salary-wage in manufacturing had gone up to $2,043, compared with $1,660 for all nonagricultural industries. Manufacturing employment expanded from 10.1 million in 1939 to 14.6 million in 1942. Wage-earners in manufacturing increased from 8.2 million in 1939 to 12.5 million in 1942.

In 1939, the average salary-wage in industries making machinery, transportation equipment, and other metal products was $1,551, as compared with $1,309 for all manufacturing industries and $1,284 for all nonmanufacturing industries. By 1943, the average salary-wage in industries making machinery, transportation equipment, and other metal products was $2,553. Of course, the figure for 1942 is greatly affected by an increase in weekly hours and by a large amount of penalty overtime.

Wage-earners in machinery, transportation equipment, and other metal products increased from 2.6 million in 1939 to 5.6 million in 1942. Although payrolls as a whole did not quite double between 1939 and 1942, payrolls in manufacturing increased two and one-half times, and in machinery, transportation machinery, and other metal products over three times. *Survey of Current Business*, March 1943, pp. 17 and 23. Wages and salaries in all manufacturing increased from $13.2 billion in 1939 to $30.7 billion in 1942. Wages and salaries in the manufacture of machinery, transportation equipment, and other metal products increased from $4.9 billion in 1939 to $17.0 billion in 1942.

tion, and the cost of living would have been 50 to 100 per cent above its present level.

The development of national wage policy has been very gradual. Not until the President's message of April 27, 1942, did the government have a national wage policy. This policy has been implemented and developed gradually by the Little Steel decision of July 16, 1942, the Act to Amend the Price Control Act of October 2, 1942, and the Hold-the-Line Order of April 8, 1943.[11] The policy is somewhat indefinite, but the general rule is that for groups of workers hourly wage *rates* are raised in proportion to the increase in the cost of living between January 1941 and May 1942.[12] This is the well-known Little Steel formula. The policy assumes that the cost of living will be held to the levels of May 1942. Wage increases are also

[11] The efforts of the government to establish a national wage policy illuminate clearly the inadequate arrangements for policy making in the structure of our government. The National Defense Mediation Board took the position that it was not intended to make wage policies. There is much to be said for the Board's view—although one has difficulty in seeing how the Board could decide wage cases without discrimination unless it based its decisions upon general principles. Nevertheless, the Board was plainly entitled to either a framework of policies or a specific mandate to make wage policies. It was prevented from receiving either authorization by the difference of opinion between Congress and the President over who should make labor policies. The President wished to reserve the making of labor policies to himself. Indeed, when he asked Congress to implement a stabilization program in April 1942, he did not ask Congress to make a policy about wages. Rather he said that if Congress would do something about taxes and prices, *he* would undertake to stabilize wages. Obviously, 531 men cannot make policies in a very creative fashion—they can do little more than discuss and approve or disapprove policies proposed by an executive or their own committees. Not until September 1942, did Congress take matters into its own hands and, regardless of the executive, undertake to give the country a national wage policy.

[12] The basic formulation of the policy is the Act of Congress of October 2, 1942 which "authorized and directed" the President "as far as practicable" to stabilize wages at the levels of September 15, 1942. The qualification "as far as practicable" enabled the President to retain the Little Steel formula. He promptly ordered the War Labor Board to approve no advance in wages above the rates prevailing on September 15, unless the increase was necessary to correct "maladjustments", "inequalities", or to aid in the "effective prosecution of the war". "Maladjustment" exists when the wage rates of a group have not gone up as much as permitted by the Little Steel formula —namely 15 per cent above January 1941.

permitted for the purpose of removing "inequalities" or promoting the effective prosecution of the war. The War Labor Board has been liberal in granting exceptions to the Little Steel formula.[13] The development of national wage policy has consisted mainly in narrowing the basis for exceptions to the general rule.

The national wage policy has been denounced by some persons as inflationary on the ground that raising wages to meet increases in the cost of living would, in turn, cause the cost of living to rise, thus creating a vicious spiral. Nevertheless, for the last two years the rate at which wages have risen has gradually been decreasing. In 1940, wages were stable—straight-time hourly earnings (corrected for shift from low-paying to high-paying industries) increased only 2.0 per cent. The largest rise came during the first half of 1941, when the rapid expansion of defense production led straight-time hourly earnings in manufacturing (corrected for shifts) to increase 6.6 per cent. From that time the rate of increase, with minor exceptions, has been steadily downward. In the second half of 1941, straight-time hourly earnings (corrected for shifts) increased 5.8 per cent, and in the first half of 1942 by 4.1 per cent, in the second half of 1942 by 4.5 per cent, and in the first half of 1943 by 3.7 per cent.

The rate of increase in straight-time hourly earnings (corrected for shifts) had started to decline before the nation had a wage policy, and the institution of the policy has not accelerated the decline in the rate of increase. In other words, statistical evidence is sadly lacking that wage policy has affected the course of wages. This does not mean that the policy has had no effect because pressures on wage rates may have been growing. It probably does mean, however, that the most important restraint on wage increases has been the oppor-

[13] In about 23 per cent of the fully approved cases "maladjustment" or failure of wages to rise by 15 per cent above the level of January 1941 has been the major reason for approval; substandards in 11 per cent; gross inequities and intra-plant differentials in about 51 per cent; and other reasons in about 15 per cent. In non-dispute cases the Board has given full approval in three cases out of five; partial approval in nearly one case out of four, and has denied the application in only one case out of six. The above percentages include the Regional Boards as well as the National Board.

tunity to move into higher paying jobs. The next most important restraint has been the strong hostility of the public toward strikes. Both of these influences affected wages before the country had a wage policy. Curiously enough, the most important development of all, the Little Steel formula, was followed by a temporary *rise* in the rate of increase in straight-time hourly earnings. Likewise, the increase in the quarter following the Hold-the-Line Order of April 1943 was slightly more than during the quarter preceding it.[14] Regardless of how it has been accomplished, however, reasonably effective control has been established over the price of labor.

V

Has the national wage policy promoted the effective prosecution of the war? Would output have been greater had there been more control of wages, less control, or a different kind of control? Has the policy been fair to the workers and fair to the rest of the community? These are questions which, strictly speaking, I have not been asked to discuss. I have been asked only to analyze the relationship between wages and inflation. Nevertheless, I cannot escape asking whether the national wage policy is likely to be continued in about its present form or whether it is likely to be modified to promote the more effective prosecution of the war or to meet complaints of unfairness from the workers or the public. Is it likely to be modified in ways which make it more inflationary or less inflationary than it now is?

The national wage policy has never been carefully integrated with manpower policies. The War Labor Board has given increases to nonwar workers on the grounds of inequality or gross inequity even though such increases may discourage men from

[14] Mr. W. H. Davis, Chairman of the National War Labor Board, recently said that had the rate of increase from January 1941 to October 1942 not been arrested, average hourly rates would have increased five times as much as they actually have done since October 2, 1942. (Press Release B-1015, October 2, 1943.) This statement implies that since the Act to Amend the Price Control Act of 1942 there has been a sharp drop in the increase in wage rates. This may be true, but satisfactory evidence in support of the statement is lacking. Straight-time hourly earnings in manufacturing (corrected for shifts) increased 1.5 per cent in the last quarter of 1942, 1.8 per cent in the first quarter of 1943, and 1.9 per cent in the second quarter of 1943.

leaving nonessential jobs for war work. The Board holds that it is responsible for making the wage structure as fair as possible pretty much regardless of the effects upon problems of manpower distribution. With this position of the Board I agree, at least as far as removing inequalities and inequities is concerned. Perhaps the Board should use the "effective prosecution of the war" clause to grant, on request of the War Manpower Commission, special and temporary wartime bonuses to induce more men to move into certain industries or into certain localities. After the war, when we have more leisure to indulge in the wisdom of hindsight, we shall probably conclude that the wage policy lacked flexibility and adaptation to the special needs of some war industries and war communities.

Has the policy been fair to the workers and to the community? Representatives of the A. F. of L., the C.I.O., and the railroad brotherhoods, meeting recently with President Roosevelt, called the Little Steel formula "out-dated, unworkable, and untenable in the light of price increases".[15] The C.I.O. Convention demanded that the formula be scrapped and that collective bargaining be substituted for it. If the present policy is abandoned or modified, what should be the new policy or the modifications of the present one?

The national wage policy seems, on the whole, to have been fair to the workers. It is true that the policy protects the wages of January 1941 against a rise in the cost of living of only 15 per cent, and that the index of the cost of living has risen 22.5 per cent above January 1941. The actual cost of living has risen more than the index. If the link between wages and the cost of living is defensible up to May 1942, should it not be continued after May?

In defense of the policy two principal observations are to be made. One is that the war has given millions of workers an opportunity to shift into higher paying jobs. This opportunity alone is worth $13.4 billion a year—equivalent to an increase of one-fourth in the wage rates of January 1941. Perhaps in this connection it should be repeated that the war has given thousands of men an opportunity to work overtime at rates which were intended to be prohibitive—worth over $2 billion a year. The second observation is that the wage

[15] A. F. of L. *Weekly News Service*, October 26, 1943.

adjustments permitted by the Little Steel formula are in *rates* rather than in straight-time hourly *earnings*. Nearly two-thirds of factory wage-earners are paid by results. Among these workers the real price of labor may rise substantially, despite the fact that piece or bonus rates remain unchanged—in fact, this is the usual course of events. The reason is that many small improvements in equipment, raw materials, and working conditions are constantly helping piece or bonus workers to increase their earnings.[16] Even men in plants where payment is predominantly on a time basis have fared generously under the Little Steel formula, because fictitious upgrading (of which there is much in the present tight labor market) has raised hourly earnings substantially more than rates. Largely because of the improved working conditions of pieceworkers and fictitious upgrading the average straight-time hourly earnings of factory workers (corrected for shifts) has risen faster than the index of the cost of living since January 1941—27.7 per cent up to August 1943, as compared with 22.5 per cent in the index of the cost of living.[17] Many nonfactory workers, however, have not fared so well. It is among the nonfactory workers, especially the white collar workers, that there is most ground for complaint against the national wage policy.

The complaint that the index of the cost of living fails to measure the real advance in living costs is a criticism of one of the tools used in applying the wage policy rather than of the policy itself. Admittedly, the index cannot measure with precision the decline in the quality of goods or services or capture all of the departures from ceiling prices.[18] Nevertheless,

[16] A multitude of illustrations could be given, especially in the metal trades. In a textile mill weaving indigo cloth for the navy, loom efficiency and piecework earnings went up 38 per cent after the management learned how to control the quality of the yarn. Piece rates were not changed, with the result that earnings reached record-breaking levels for this group of workers.

[17] Between May 1942 and August 1943, the index of the cost of living rose 6.2 per cent and straight-time hourly earnings (corrected for shifts) 10.4 per cent.

[18] The index cannot take account of the poor quality of dyes, the meagerness of cut, the fewer stitches. Nor can it take account of extra carrying of bundles, of the fact that it takes a week longer than usual to get one's

the index does represent reality better than most of its critics suspect. It goes without saying that in times like the present redoubled efforts should be made to keep the index as realistic as possible. If these efforts fall short of perfection, as they must, labor is not in a strong position to complain. In the first place, the poor quality of goods and services is suffered by everyone, not by wage-earners alone. It is one of the costs of the war. In the second place, many wage-earners profit in the sale of their own services from the drop in standards of quality. Inexperienced men from nonmanufacturing industries have been given jobs in factories at rates which would ordinarily be paid only to experienced men. In the third place, the abnormal expansion of the work force by 7 million has greatly reduced the non-workers who must be supported by the workers—from 2.4 dependents per worker in 1940 to 2.1 at present.

Although the present wage policy seems on the whole to have yielded rough justice, this result has been partly produced by compensating defects in the policy. Consequently, modifications are desirable. The most obvious one is to continue the link between the cost of living and wages beyond May 1942, provided this can be done without creating a dangerous spiral of price and wage increases. This modification is especially needed for nonfactory workers. The extension should be accompanied by renewed efforts to make the index of the cost of living better reflect present market realities. A second adjustment needed in the national wage policy is that the relationship between wages and the cost of living be based upon straight-time hourly *earnings* rather than upon wage *rates*. This change would be more nominal than real. Although the Board has never explicitly said that it would not raise rates when straight-time hourly earnings have increased by the amount of the cost of living, only in rare instances has the Board raised rates under these circumstances. Unless the

piece work rates

laundry back, or that one's chance of getting a seat on a street car or bus is only half the pre-war chance. Adjustments have been made to allow for the disappearance of certain types of durable goods from the market. Black markets, above-ceiling quotations, the smaller frequency of "sales", the abandonment of "loss" leaders are to considerable extent reflected in the index. So also is much of the deterioration in the quality of goods.

Board continues to be guided by straight-time hourly earnings rather than by rates, the extension of the linkage between wages and the cost of living beyond May 1942 would produce a dangerous spiral of wage-price increases. A third adjustment needed in the Little Steel formula is that timeworkers as a group be permitted to get rate adjustments sufficient to raise their earnings by the amount of the cost of living when their earnings have fallen far behind the earnings of piece or bonus workers in the plant. The problem of disparity between the earnings of timeworkers and pieceworkers is not a new one, but it is particularly acute today and is steadily becoming more acute. In ordinary times readjustments are made in piece rates as small improvements occur in conditions of work. During the tight labor market of the last several years, however, the usual readjustments have not been made. Consequently, the straight-time earnings of pieceworkers and bonus workers in many plants have soared far above the earnings of timeworkers.[19]

Would the proposed changes in the national wage policy start a dangerous upward spiral of wages and prices? The answer is "No." In most manufacturing plants the proposed modifications would produce no change in wage rates, because straight-time hourly earnings have more than kept up with the cost of living. Most of the adjustments resulting from the proposed changes would be in nonmanufacturing plants and among timeworkers. If the cost of living continues to rise, proportionate increases in labor costs would not be inevitable, because managements could keep down rates by helping pieceworkers to raise their hourly earnings. The proposed changes in the national wage policy might produce a slow, creeping rise in prices, but the rise would not be faster than during the last year or two. As I shall point out presently, a continued gradual rise in prices and wages is probably desirable.

If the Little Steel formula were revised as I have suggested, payrolls would increase between 1943 and 1944 by about $7

[19] Permitting upward adjustments of timeworkers on the basis of intra-plant inequality may precipitate claims from timeworkers in other plants who plead inter-plant inequality. Hence readjustments in the wages of timeworkers on the basis of intra-plant inequality should be permitted only where the changes will not create inter-plant inequalities.

billion—about one-third of the increase between 1942 and 1943. Straight-time hourly earnings would rise about 5 per cent. The reason for the moderate increase in payrolls is that three of the principal causes for the recent rise in payrolls are disappearing: the size of the working force is no longer increasing; little further increase is to be expected in the hours of work; and the large movement from the low-paying plants and industries to high-paying plants and industries is almost over. If the war against Germany continues throughout most of next year, the supply of consumer goods will be smaller than this year. But even if the cost of living rises by 4 per cent or 5 per cent, the "inflationary gap" will be roughly $8 billion greater than in 1943.[20] This, however, does not mean inflation. The public has already demonstrated a marked disposition not to reach for goods at fancy prices and to conserve its purchasing power until the kinds of goods it wishes to buy are available. If the war against Germany ends by spring, which is possible, the "inflationary gap" next year will be considerably less than this year.

VI

The foregoing analysis suggests that the real danger of a disorderly rise in prices does not spring from the increase in the inflationary gap or from the slow increase in prices which would be produced by the present wage policy or by the proposed modifications of it. Rather the real danger springs from the possibility that the national wage policy will be wrecked by the insistence of aggressive and powerful groups upon preferred treatment. Experience shows that some groups in the community are willing to withhold supplies from the men at the front in order to gain a few additional cents per hour for themselves.

At the present time strikes for higher wages are not illegal, but employers may not pay higher wages without the approval of the War Labor Board. Hence, as a practical matter, the only strikes possible on a general wage issue are strikes to coerce the Labor Board. General prohibitions against strikes have never worked satisfactorily and I do not advocate them.

[20] See S. H. Slichter, *Present Savings and Postwar Markets* (New York and London, 1943), pp. 36-40.

But plainly the Labor Board cannot permit itself to be coerced. It cannot *reward* strikes (or threats of strikes) by giving favored treatment to groups which are tough enough to insist upon it. Yielding to pressure or threats would quickly produce chaos. Regardless of what the national wage policy is, regardless of who likes it or opposes it, the Board must apply the policy without fear or favor to all groups, large and small, weak or powerful. That is the keynote to any anti-inflationary policy. The War Labor Board and the Railroad Emergency Boards are bound from time to time to make decisions with which many people will disagree. If the country is to have a stable wage policy which is enforced regardless of threats, the arbitrating bodies must have more support from Mr. Byrnes, from Mr. Vinson, from the President, and especially from the public than they have thus far received.[21] Specifically this means that Mr. Vinson must accept all decisions of the Labor Board that do not produce price adjustments to which the Office of Price Administration objects.[22] Only if the Boards receive unqualified support can they successfully resist the attempts of special groups to win favored treatment.

If special groups seek to enforce preferred treatment by stopping war production, I see no alternative except to call them to the colors and to put them to work as members of the armed forces. This is not a happy solution and I suggest it with reluctance. And yet what else can the country do if it is forced to choose between having its soldiers and sailors deprived of goods or of having its wage policy wrecked and the control of

[21] The President, in particular, has for some time shown a disposition to indulge in personal government in the handling of labor matters. He set a bad precedent in refusing to accept the recommendations of the Emergency Board of December 1941, and in proposing modifications in the decision of the Emergency Board for the nonoperating employees last spring. Mr. Vinson unfortunately followed the precedent of 1941 in handling the case of the nonoperating railway employees last spring.

[22] It is shockingly bad administration for Mr. Vinson (or the President) to substitute their ideas of justice for those of a board of well-qualified men who have spent weeks or months hearing the case and who have acquired a familiarity with the issues or the facts which Mr. Vinson or the President cannot hope to match. Unfortunately, the same type of bad administration (refusal of uninformed superiors to be guided by the judgment of experts) exists in other fields—notably in the refusal of Mr. Vinson to accept the recommendations of food experts with respect to the price of corn.

prices jeopardized by competitive seeking of wage increases? New legislation would, of course, be required.

VII

What will happen to payrolls and to wage rates after the war? What effect will changes in payrolls and wage rates have upon the general economic situation? Will the National War Labor Board be promptly abolished? Will there be mass unemployment and a drive of employers against wages or will there be a rush to buy goods and an upward movement of wages?

If wage rates after the war remain unchanged, payrolls will drop by over $20 billion. This drop will come about because of a shrinkage of about 3.8 million in the size of the working force, of about 4 per cent in the length of working hours, and a large shift from high-paying to low-paying jobs.[23] If payrolls reach $108 billion in 1944, they may be expected to drop at high employment in two years to about $86 billion. This is about 17 per cent below the present level of payrolls, but nearly double the pre-war level.

What will happen to the price of labor? The demands for wage increases will be numerous and insistent.[24] Whether

[23] A rough estimate of the effect of these three influences is as follows:

A drop of 3.8 million in the size of the working force . .	$ 5.8 billion
A reduction in the length of working hours, including loss of penalty overtime	5.8 "
Shift from high-paying to low-paying jobs	10.0 "

The above estimates assume a working force of 59.2 million and an unemployment rate of 2 million after the war. A normal rate of increase would produce a working force of about 58.2 million in 1946. It is assumed that the armed forces drop from a peak of 10.5 million to a permanent post-war establishment of 2.5 million and that the number of nonagricultural employees rises from 37.6 million in 1944 to 38.5 million in 1946. The shrinkage of payrolls as a result of the shift from high-paying to low-paying jobs is very difficult to estimate. I assume that for some time after the war employment in the durable goods' industries will be abnormally high. Hence I assume that only two-thirds of the gain from the shift into high-paying industries is lost. This assumes that wage rates in the low-paying industries are not raised after the war.

[24] These demands will spring mainly from three reasons: (1) workers shifting from high-paying war jobs to low-paying peacetime jobs will seek compensating wage increases; (2) men who lose lucrative overtime work will

these demands are successful or not will depend in the main upon (1) whether wages are high or low relative to other prices when the war ends, and (2) whether predominating influences after the war are inflationary or deflationary.

When allowance is made for the drop in quality of commodities and services, the real prices of finished goods appear to have risen slightly more than the price of labor—about 30 per cent since 1939 as compared with about 21 per cent in the price of labor.[25] In view of the large increase in the prices of raw materials (over 60 per cent since 1939) this is what one would expect. Corporate profits, before taxes, have advanced rapidly—from about 5.4 cents per dollar of sales in 1939 to 11.3 cents in 1942. This indicates that the price of labor in most industries is not so high relative to selling prices as to prevent a high rate of operation of *existing* plants.[26] Corporate profits *after* taxes, however, in 1942 were only about two-thirds as large per dollar of sales as in 1926. In 1943, it looks as if profits after taxes per dollar of sales will be even less than last year. Since it is prospective profits after taxes which determine decisions to build new plants, will wages be so high relative to other prices after the war that they will interfere with badly needed expansion? This may turn out to be true *eventually,* but I do not think that it will be true for the first few years. As I explain below, conditions for a limited period after the war will be abnormally favorable to expansion.[27]

seek compensating increases; (3) workers will seek increases to compensate for the fact that under civilian production many piece rates will yield less than under war production.

[25] This is a rough and unreliable comparison. It is particularly difficult at the moment to compare commodity prices with the price of labor because most manufactured output is sold to the government at prices which are not reflected in the price indexes.

[26] For a contrary view, see H. G. Moulton, *Postwar Collapse or Boom* (Washington, 1943), pp. 33-35. Mr. Moulton accepts hourly earnings in manufacturing as a satisfactory index of the price of labor. My reasons for rejecting this view are given above in II, footnotes 5 and 9.

[27] The figures for corporate sales in 1942 are not yet available. On the assumption that corporate sales vary very closely with gross national product, I have estimated corporate sales in 1942 at $174 billion. Preliminary figures indicate corporate profits in 1942 were 11.3 per cent of corporate sales before taxes and 4.4 per cent after taxes. The figures for the first

This paper is not the place to discuss the complicated question of whether price movements after the war will be upward

half of 1943 indicate that corporate profits will be about 3.9 per cent of corporate sales.

The following table presents a comparison of profits and price movements in selected years from 1920 to 1943:

Date	Gross National Product	Corporate Profits Before Taxes [b] (Billions)	Corporate Profits After Taxes [b] (Billions)	Corporate Sales [c] (Billions)
1926		$ 8.3	$ 6.2 [d]	$106.2
1929	$ 99.4	8.4	7.2	118.1
1937	87.7	5.2	3.9	108.4
1939	88.6	5.5	4.2	101.6
1940	97.0	8.4	5.8	
1941	119.2	14.6	7.7	
1942	151.7	19.7	7.6	174.0
1943	188.0	23.9	8.4	214.5
1943, 1st half	89.5	11.2	3.9	

Date	Ratio of Corporate Profits to Sales: Before Taxes	Ratio of Corporate Profits to Sales: After Taxes	Wholesale Prices B.L.S.: Finished Goods	Wholesale Prices B.L.S.: Raw Materials	Hourly Earnings in Manufacturing: N.I.C.B. [e]	Hourly Earnings in Manufacturing: B.L.S. [e]
1926	7.8	6.4	100.0	100.0	$ .568	$ .548
1929	7.1	6.1	94.5	97.5	.590	.566
1937	4.8	3.6	87.2	84.8	.695	.634
1939	5.4	4.1	80.4	70.2	.720	.622
1940			81.6	71.9	.739	.642
1941			89.1	83.5	.814	.689
1942	11.3	4.4	98.5	100.6	.924	.759
1943	11.1	3.9				
1943, 1st half			100.4	111.8	.995	.823

[a] *Survey of Current Business*, May 1942, p. 12, and March 1943, p. 21.

[b] *Survey of Current Business*, March 1943, pp. 22, 23; September 1943, p. 7. These figures exclude profits from intercorporate dividends and capital gains and losses.

[c] *Statistics of Income*, Part II, 1939, p. 49. The 1942, 1943 figures are estimated.

[d] *Review of Economic Statistics*, May 1943, Table II A, p. 156.

[e] The figures from the N.I.C.B. are not corrected for overtime or for shifts between industries; the figures of the U. S. Bureau of Labor Statistics for 1939 and thereafter are adjusted to eliminate the effect of overtime and shifts. The B.L.S. figure for 1940 is an average of January 1940 and January 1941. For 1941, 1942 and 1943 the figure is for the month of July.

or downward. The prospective shrinkage of roughly $60 billion in the government deficit in the first two or three years after the war leads many people to believe that deflationary influences will predominate. Raw material prices have risen far more than finished goods, and a drop in the prices of raw materials could undermine the entire price structure.[28] The war, however, is producing a large accumulation of physical needs, among both individuals and business enterprises; it is producing or advancing the development of many technological discoveries which represent investment opportunities; and it is producing an unprecedented accumulation of liquid assets.[29] Hence it looks as if the volume of investment opportunities for

[28] The influences which will govern the price of raw materials immediately after the war deserve careful exploration. In July 1943, raw materials were 61.8 per cent above the monthly average of 1939. Finished goods were only 23.9 per cent above 1939. Are raw materials likely to fall, undermining the entire price structure and deterring people from converting wartime savings into goods?

The drop in the number of workers and in the length of the working week will not mean a drop in the consumption of raw materials by industry *provided employment is well maintained.* The reason is that the decrease in the labor force will be brought about by a shrinkage in the armed services. The number of civilian workers will increase. Hence the consumption of raw materials for several years after the war at least and probably longer will exceed the wartime rate. The cessation of hostilities, it is true, will render accessible large supplies of raw materials now cut off from markets. During the war, however, inventories of raw materials have been substantially reduced. In the United States the supplies of 12 raw materials out of 20 in June 1943 were below June 1939 by the following amounts:

Less than half June 1939	4
50 to 75 per cent of June 1939	3
75 to 99 per cent of June 1939	5

Only in 8 cases out of 20 were supplies in June 1943 above June 1939—in 2 cases up to 25 per cent above; in 3 cases from 25 to 100 per cent above; and in 5 cases more than 100 per cent above. Even with new supplies accessible, a high rate of production would temporarily support most raw material prices. Over a period of years, however, it is not likely that raw material prices will remain 50 per cent above 1939—unless there is a substantial further advance in the general price level.

[29] By the end of 1943, these accumulations will approximate $65 billion; by the end of 1944 (if the war against Germany continues most of the year) over $100 billion. About one-third of these liquid assets represent fairly urgent demand. See Slichter, *op. cit.*, pp. 43-62.

several years after the war (and perhaps longer) will be abnormally large and the propensity to save abnormally low. If this is true, prices will be well sustained and employers will find it fairly easy to pass on wage increases in the form of higher prices.[30]

Regardless of whether or not the country succeeds in achieving a rise in wages and prices after the war, it is plain, I believe, that a rise would be in the public interest. There are three reasons for this belief. One is that higher wages and prices would increase the yield of tax rates more than they would raise the cost of government. Consequently, they would facilitate reductions in tax rates. A second reason is that wartime distortions in wages and prices are more easily removed by raising low wages and prices than by cutting high wages and prices. A great upheaval, such as the war, is bound to produce many distortions in wages and prices. Straight-time hourly earnings (the best index of the price of labor) have risen more in some industries than in others—over 48 per cent in lumbering and only 10 per cent in book and job printing. They have risen more on the Pacific Coast than in other parts of the country. Pieceworkers on the whole have fared far better than timeworkers. Finally, a wage and price level substantially above pre-war would be equivalent to a reduction in our tariff. It would help foreign countries to earn dollar exchange and thus would help to spread hope, opportunity and prosperity throughout the world. Indeed, a rise in wages and prices is possibly the only way of reducing our tariff which is politically acceptable to American voters. Wage rates in Britain appear to have risen about 35 per cent since 1930.[31] Since our price level (given present exchange rates) should rise more than the British price level, one may hazard the guess that the United States should seek a price level roughly 50 or 60 per cent above pre-war. Let us hope that about 10 or 15 points of the rise come in the first two or three years after the

30 Whether wage increases produce, in the main, price effects or employment effects depends upon circumstances. The conditions which will exist after the war will cause wage changes to produce, in the main, price affects rather than employment effects.

31 The Bowley index of wage rates has risen from 106 in 1939 to 144 in 1943.

war when it will contribute most to the removal of wartime distortions.

VIII

Should the movement of wages after the war be left solely to bargaining between employers and unions? Or should the country retain a national wage policy, and a national price policy as well, for several years after the guns are silent?

The pressure suddenly and completely to scrap annoying and burdensome war controls will be terrific. There is no assurance, however, that leaving the determination of wages to the bargaining of employers and unions will reduce distortions in the wage structure. Bargaining power may be so distributed that the distortions are aggravated.[32] Furthermore, there is no assurance that strong pressure for wage increases would have the desired effect upon prices. If employers find it difficult to pass on wage increases, the pressure for higher wages may be deflationary. If employers find it easy to raise prices, the pressure for higher wages may push up prices so rapidly as to generate speculative excesses. If prices rise as a result of wage increases, there is no assurance that the rise will stop at about the right point in relation to foreign price levels.

The national interest in the reduction of distortions in the wage and price structure and in controlling the rate at which

[32] After the last war the industries which experienced the greatest increases in hourly earnings during the war had decreases between 1920 and 1939, whereas the industries which had the smallest increases during the war had increases between 1920 and 1939. This is shown in the following table which is based upon figures on hourly earnings collected by the National Industrial Conference Board from twenty-one industries.

	Increase 1914 to 1920	*Change 1920 to 1939*
Ten industries above the median	173.9 per cent	— 8.6 per cent
Ten industries below the median	126.9	— 5.1
Top five	181.2	—12.8
Second five	162.6	— 4.4
First five below the median	143.3	+ 2.6
Second five below the median	110.6	+ 7.7

After the last war wage movements were less dependent than now upon the bargaining power of unions because less than one-fifth of the workers were organized.

wages and prices rise and the amount that they rise is very great. It does not seem worthy of a nation of grown-ups not to establish machinery for implementing the national interest in these matters. But how would the national interest be enforced? That is the crucial question.[33] Even in time of war, with keen hostility by the public toward strikes, the government finds great difficulty in enforcing its wage policy against unions which are determined to get preferred treatment. In time of peace, with the public weary of controls, the difficulties of enforcement would be greater than ever. For some years after the war the nation, I fear, will have to trust to luck to get the adjustments in wages which the national interest requires.

This does not mean that the country will never have a national wage policy—except in time of war. On the contrary, our economic institutions require such a policy, and it is only a question of time before the public recognizes this need. At present there is a glaring gap in our institutions. This gap springs from the fact that the level of employment depends upon decisions and policies of many economic groups which are too small to be much concerned about the level of employment. Policy making which ignores the national interest in the volume of employment can be tolerated only when employment (for independent reasons) is high. Hence, though the wage policy of the war may be scrapped soon after peace returns, it is only a question of time before the country again establishes a national wage policy to guide the operation of collective bargaining.

[33] There are various well-known ways of influencing the movement of prices and these might be sufficient to establish satisfactory control over the wage level during a period when the propensity to save is abnormally low and the investment function unusually favorable to employment. Under such conditions indirect controls over wages might be satisfactory, at least for the time being, even though they do not prevent wages from rising faster than prices and encroaching upon profit margins. There might be trouble, however, after the accumulated consumer and investment demand had been pretty much met and the propensity to save and the investment function had reached a more or less normal position. At this point continued encroachments of wages upon prices would be dangerously deflationary.

Price controls, such as a budget surplus or deficit or inventory controls, would not, of course, eliminate distortions in the wage structure except by accident.

Remarks by the Chairman

Chairman Ransom: As the last speaker at this morning's session, the Academy is more than usually honored to have a distinguished statesman, a leader and public servant, from our sister democracy to the north.

You all know how close have been the ties between the Dominion and the States during the war, how active and many-sided has been the coöperation, and how intent has been the interest of leaders of thought on both sides of the almost nonexistent boundary, in the way in which the respective countries have handled problems which, of necessity, were very closely similar.

The Canadian Minister of Finance, Mr. Ilsley, was born in the Annapolis Valley in Nova Scotia. After attending Acadia College and Dalhousie University in law, both in the Maritime Provinces of Canada, he was called to the Bar in 1916, at the early age of twenty-two, and was elected to the Dominion Parliament in 1926. In 1935, he became the Minister of National Revenue for Canada. This was at the age of forty-one, which made him one of the youngest men ever to hold a Cabinet post in the Dominion government of Canada. Shortly after Canada entered the war he became Minister of Finance, and, since 1940, he has had the responsibility for Canada's finances and many of the allied problems in relation to finance. While his career, beginning as a lawyer, has been primarily that of a public servant, and while he may not be known as the most astute politician in Canada, we in the States have interest in a man who has never been defeated for public office. [Laughter]

As one who has opportunity from time to time to witness sessions of the Dominion Parliament in Canada, I think I am warranted in saying that, next to the Prime Minister, our guest of honor this morning maintains the great tradition of debate in the Parliament at Ottawa.

As Minister of Finance, he has been particularly admired throughout Canada and elsewhere for his courage and his straightforwardness in acquainting the Canadian people with their responsibilities and difficulties. He has shown great energy in telling the story to the people throughout Canada. Shortly after being responsible for imposing very much higher taxes on all classes in Canada, I recall that he went from one end of the Dominion to the other, speaking many times a day, and for six weeks, to explain these increases in taxes. He put over a Canadian war loan in an amount that had not hitherto been deemed within the range of possibility, topping the highest figure that had ever been reached up to that time.

Those of us who spend considerable time in Canada have been interested also in the fulfillment of his responsibility for the Prices and Control Board, as to which I venture to say that rationing and price control in Canada have been considerably less vexing to the public than they have been on this side of the border.

I now see, as you do, that I do not need to emphasize further in language what we all feel in our hearts, that with the great burdens which rest upon public officials in high place in these times, the Academy of Political Science never had a finer honor than that Canada's distinguished Minister of Finance has come down to talk to us at this time, with a message to this country regarding the problems of post-war and present monetary stabilization. The Honorable J. L. Ilsley, Minister of Finance of the Dominion of Canada!

THE PROBLEM OF MONETARY STABILIZATION

THE HON. J. L. ILSLEY, M.P.
Minister of Finance of Canada

I APPRECIATE the invitation to address this distinguished Academy and the opportunity it affords me to speak briefly to you about the problem of monetary stabilization from the Canadian point of view. I should make clear at the outset, however, that I must speak to you not as a political economist, but as a political practitioner. Consequently I can hardly hope to shed new, scientific light on this subject, but rather to offer you only the personal reflections upon it of a man in active public life. What I say today is not to be construed as a statement on behalf of the government of which I am a member.

It is of the greatest importance that we start off at the end of the war in the right direction and with sufficient speed on the re-shaping of international affairs. It will be a time of great opportunity and heavy responsibility. The world will be in a state of flux, particularly that part of the world represented by international affairs and institutions. The people of all nations will be prepared for substantial change — indeed they will be expecting and hoping for great improvements over pre-war conditions. Those who determine the policies and mold the institutions of this post-war world will leave their mark, we may expect, upon the history of many generations.

In the economic field there will be two great objectives. The first, we may be sure, will be full employment. The importance of full employment has been burned into the consciousness of all citizens of the Western world by the experiences in the ten years preceding the war. The second great objective, stated generally and somewhat unfamiliarly, will be the most effective employment, that is to say, the best obtainable division of labor and organization of production, both domestically and internationally. Much can be said about each of these broad objectives by economists, and we may be sure that much will be said. What I wish to emphasize to you now is simply that to secure

each of these objectives, international conditions and international action are required, which depend for their success in very considerable part upon achieving satisfactory monetary and exchange relationships between nations.

These are needed to secure full employment in most countries, if not all, because full employment requires a high level of exports and of imports. Imports of materials, equipment and consumer goods are required to support production and afford a reasonable standard of living to those engaged in it. To secure those imports a nation must be able to obtain adequate supplies of foreign exchange. Only when it is assured of these supplies can it follow an effective domestic program designed to secure full employment without fear of running short of essential imports. Moreover, most countries, particularly those like my own, can secure full employment only with a large volume of exports. To employ all our people otherwise would require a vast reorganization of our whole economic life.

Here we reach the reason why satisfactory monetary and exchange arrangements are needed for effective employment. The population of any country and of all countries can be effectively employed only if the products of one country can be exchanged for the products of another. I need not attempt to argue to this audience the basis or necessity of international trade. I only wish to remind you that such trade can flourish only if foreign exchange rates are sufficiently stable to enable traders to carry on their business, and if foreign exchange reserves are sufficient to permit nations to follow far-sighted policies designed to encourage trade, rather than short-sighted policies intended to protect their exchange positions. We may be sure that if many countries are seriously short of foreign exchange after the war and if exchange rates at the same time, and as a consequence, are unstable and subject to arbitrary variations, we shall see narrow, short-sighted trade policies; we shall see high protection instead of lower tariffs and the absence of quotas; we shall see bilateral deals such as we saw in the early 1930's; we shall see the formation of trading and exchange blocs which prevent trade flowing in its natural and most efficient channels; moreover, we shall, in such conditions, see domestic programs in most countries delayed, hindered and

distorted by the need to find substitutes for export markets and for imported supplies.

We cannot hope to meet this problem of monetary stabilization by reëstablishing the gold standard as it was some years ago. Gold is and will doubtless remain the best form in which international exchange reserves can be held. Many countries, however, do not have the gold reserves that would be needed to enable them to adopt the gold standard of the classical type. Some means must be found of supplementing gold for such countries. Even if they had adequate reserves, many countries would be most reluctant to undertake the rigid commitments involved in basing their domestic financial policies upon their gold reserves alone, even at the cost at times of unemployment and at other times of inflation. The gold standard of classical lines necessarily involves such commitments, expressed or implied. In the public mind this gold standard is not associated with those periods before 1914 when it worked well and helped to promote good trade, employment, and foreign lending to develop the world. Instead it is associated with the troubles and the confusions of the 1920's and the 1930's. The average citizen may not know more about the traditional gold standard than its name, but he is thoroughly convinced that we must not return to the unhappy economic experiences which characterized much of the period between the wars.

The gold standard was only a means and not an end. The real problem is to improve upon and supplement it, retaining whatever advantages there were in it, but avoiding the dangers which were involved in its inflexibility and its blindly automatic character. I think such a superior alternative can be found.

Such an alternative solution must, I believe, accomplish three specific objectives. In the first place, it must provide reasonable, stable exchange rates linking various national currencies together, avoiding arbitrary and competitive alterations in such rates. Secondly, it must provide adequate reserves of foreign exchange to each country, enabling it thereby to maintain a reasonable stability in its exchange rates and to meet temporary excesses of imports over exports. That is to say, it must furnish an adequate fund of international working capital supplementing gold reserves which, while perhaps adequate in

total, are distributed in such a manner that they will no longer serve this purpose by themselves. Thirdly, the solution should provide an agreed method and mechanism for securing the adjustments required to keep the payments and receipts of countries in reasonable balance, thus ensuring that exchange reserves are not dissipated heedlessly or needlessly. In accomplishing this purpose it will be necessary to arrange for such adjustments of exchange rates as are required and are justified by underlying conditions rather than by temporary circumstances or arbitrary and selfish action.

It is to accomplish these objectives that experts of the United States, Britain, Canada and other nations have been putting forward proposals for agreements to establish international exchange funds or clearing unions.

The general nature of these proposals is relatively simple, though the details soon become highly technical for a layman. Essentially it is proposed that countries will agree together, through a new agency, on exchange rates that they will adopt after the war, on the general nature of the circumstances under which, and the procedure by which, they will agree to alterations in such rates, and on the establishment of an international fund on which each member country may draw, up to specific amounts and subject to certain types of conditions at various stages. It is also proposed that the new agency will serve to assist individual countries in maintaining a reasonable balance in their international receipts and payments. The new agency would not take the place of the ordinary foreign exchange market or of the ordinary international operations of commercial or other private banks. It would deal only with or between national treasuries or central banks, providing balances of foreign exchange required to maintain the equality of demand and supply on the exchange markets at the established rates.

When the proposals of the British and of the American experts were made public almost simultaneously last April, they appeared to differ quite considerably, both in form and content. The British proposal took the form of a persuasive essay proposing the establishment of a clearing union, which would employ a new international currency. Member countries would be given a line of credit in this new currency, entitling them to borrow up to specified amounts subject to agreed conditions

beyond certain points. Countries would not be required to make any initial contribution of capital, but instead would each agree to accept the new international currency from other countries in exchange for its own money. The plan was simple and logical, but radically new and based on the overdraft principle of English banking, which is not familiar to many of us on this continent.

The American proposal took the form of a draft constitution for an international stabilization fund, to which each country entering the agreement would contribute some of its gold and some of its own currency, and from which it would have the right to buy foreign exchange up to specified limits and subject to certain agreed conditions when it had bought more than certain specified amounts. The proposal was necessarily detailed and complicated, but based essentially upon a familiar institution—the exchange stabilization funds which many countries had themselves established in the 1930's. I should also mention the fact that the American proposal set limits to the total commitments which countries would be asked to make in providing their own currency to the international institution, whereas the British experts believed that a limit on what the deficit countries could borrow would be sufficient.

Many in Canada felt that it was of great importance to secure some international agreement on this matter at an early date. Our experts believed that the British and American plans were really quite similar in fundamentals, but differed so much in form and appearance that it was worth while attempting something in the nature of a compromise. They therefore put forward proposals and comments in a document entitled, with all possible qualifications, "Tentative Draft Proposals of Canadian Experts for an International Exchange Union". These proposals, like their British and American counterparts, do not carry any endorsement of the Canadian government, which has not yet been able to give thorough consideration to these matters.

The Canadian experts based their suggestions on the form of the United States plan, feeling, I believe, that that form, though perhaps less neat than the British proposal, was more likely to meet with general acceptance. They also adopted the principle of limiting the commitment to be accepted by coun-

tries in supplying their currency to the international organization, not so much because it was a fundamental necessity as because it was desirable to avoid even the appearance of an unlimited obligation.

Numerous minor suggestions were made by the Canadian experts for modifications in the American proposals, but I shall confine myself to mentioning the three major alterations which they suggested. The first was in regard to the size of the fund. The Canadians felt that the fund proposed by the American experts was on the small side and might well prove inadequate to the burdens that would be thrust upon it. They felt that it would be safer to have a fund that would be somewhat larger than necessary, rather than to have one that was in danger of proving smaller than necessary, since fear of inadequacy would be bound to lead to premature demands upon the fund in the endeavor by various countries to make full use of it before it ran out of the currencies that were most in demand. Consequently the Canadians suggested a fund with assured resources equivalent to some 12 billion dollars, whereas the American fund had been "at least 5 billion dollars".

The second major modification proposed was that the decisions of the fund should be taken by simple majorities rather than the large majorities suggested in the American plan. These requirements for large majorities would have had the effect of giving the largest countries a veto power over decisions, which the Canadians believed was not only undemocratic but apt to lead to the danger of mere inaction, since the vetoing Power would be unable itself to put through alternative measures. One exception was left, that is, any decision revaluing the international unit and thereby other currencies, in terms of gold. It was felt that the United States and other large countries should be left with veto power over any decision which would alter the gold content of their currencies. Instead of the veto power on other decisions, the Canadians proposed that countries which on balance had not needed to obtain foreign exchange from the fund would be free to withdraw from the fund on very short notice, thereby ending any commitments in which they might have become involved by continued membership in a fund with the policy of which they did not agree.

The third modification suggested in the Canadian proposals involved more provision for the adjustment of exchange rates under specified types of circumstances. It was felt that there would be great difficulty in establishing, immediately after the war, exchange rates which would prove exactly suitable to conditions that would undoubtedly differ greatly from those in the past. Consequently there should be more leeway left for adjustment in the light of experience after the war. The Canadian experts felt that if the stabilization were too rigid, many countries might be reluctant to join the Union for this reason. Care was taken, however, to protect against arbitrary changes in rates.

After these Canadian proposals were put forward, and following other informal exchanges of views, the United States experts brought out a revised draft of their proposals. This revised American proposal provides for more adjustment of the rates initially established than did the original, and also reduces considerably the instances in which a veto power can be exercised.

Undoubtedly many further improvements can be made in these international proposals. I would hope that the experts of the various countries would soon be able to reach agreement on a satisfactory draft for the consideration of governments. In the meantime the public, parliamentary and congressional representatives, and independent experts of all kinds are having a chance to examine and discuss the various suggestions. This will enable an informed public opinion to be ready when the time comes for congresses and parliaments to consider and act upon this problem.

I think that some solution to the problem of monetary stabilization, along these general lines, will be necessary and will be possible. A plan of this kind would seem to me to offer the following advantages:

First, it would provide all the member countries with a reasonable reserve of foreign exchange, which would enable them to follow far-sighted, liberal trade policies and domestic employment policies, rather than short-sighted, restrictive policies which might otherwise be inescapable.

Secondly, by securing a large measure of exchange rate stability it would provide an international atmosphere in which

trade could be conducted without great risks, and in which nations could borrow and lend capital to finance trade and to develop the undeveloped parts of the world.

Thirdly, it would enable countries to avoid the need for restrictions on the exchange of one foreign currency for another, thereby making it possible, as Lord Keynes has concisely put it, "to provide that money earned by selling goods in one country can be spent on purchasing the products of any other country." This would enable trade to move freely in the directions in which it flows most naturally, rather than being confined to bilateral dealing between two countries, with others excluded. This is of great importance to Canada, among other countries, for our resources and needs are such that we normally sell to Britain, and to Europe generally, more than we purchase there, and we convert the balance into dollars to make greater purchases in the United States, which is our nearest and most natural source of supply for many items. In this way, a monetary plan of this type is vital to securing the disappearance after the war of the many discriminatory practices that arose during the 1930's.

Fourthly, by thus enabling wiser policies to be followed, and creating a much more favorable atmosphere for international trade and lending, without bilateral dealing and exchange discrimination, a plan of this kind should help greatly in bringing about not only more trade between nations, but greater employment and production within nations. This must be reckoned as its principal advantage.

A further, and fifth, advantage is that the creation of an international fund of the kind proposed obviates, at least to a very large degree, the necessity for direct credits from one country to another for the purpose of supplying gold or exchange reserves. Instead it interposes an impartial and democratically controlled agency with a basis of action agreed on and recognized in advance of particular applications.

Finally, there is great value in achieving these various ends by the voluntary and democratic association of all like-minded nations, securing by agreement and joint action advantages which cannot be secured by each acting alone. No surrender of sovereignty is really involved. Countries would be more able, rather than less able, to pursue sound economic policies of their

own. The only limitations which are involved are the agreed conditions on which access to the benefits of membership are secured, and the observance of these conditions by all is itself part of the benefits which each would seek by agreement. What is proposed is an international agency, not a supernational power.

These benefits and advantages which I have outlined are not gained by one country at the expense of others. They are mutual benefits shared by all who participate in the plan.

Time does not permit me today to deal with the separate implications of the plans for those countries which can expect a chronic deficiency of exchange, or a chronic surplus. Countries with chronic deficiencies will receive only limited assistance to give them time to correct their basic position and technical aid in doing so; the plans cannot and will not permit any country to live beyond its resources indefinitely. On the other hand, countries having a persistent surplus of exports over imports will be likely on balance to be providing their currency to others through the fund as agent, in return either for gold or for credits with the fund secured by all its assets. I would expect the United States and Canada may find themselves in this position. If so, we must not regard our participation as an act of generosity. Our accumulation of credits with the fund, or gold, will merely reflect our desire and ability to sell more abroad than we are willing to purchase abroad or to finance on long-term credits. If we do not wish to continue providing funds in this way, we shall be as free as we ever have been to correct the position by importing more, exporting less, or lending abroad. In one way or another we must accept the responsibilities of countries who are persistent creditors on current account.

It seems to me that there is no better alternative form of monetary stabilization. The traditional gold standard, as I have indicated, is not likely to be generally acceptable. Some persons, I realize, feel that there is an alternative approach which would aim at securing stable exchange rates between currencies of the major "key" countries, leaving all other countries to group themselves about one or another of these major units when they were ready and able to do so and to stabilize their own currencies thereby, presumably with the

assistance of the "key" country concerned. This plan, I believe, has three serious faults. In the first place, it is not enough to stabilize only the key currencies. Many countries which are less than Great Powers are still of importance—not only to one another but even to the major nations. American farmers, manufacturers and other producers are interested in the exchange rates of Canada, Argentina, Denmark, Brazil and Sweden, for example. Secondly, stabilization of the key currencies must involve direct credits from one major country to another, possibly on quite a large scale as each major country must carry the burden of its satellites. Such credits would, I think, be just as difficult to make and to accept as credits to or from an international agency, and would certainly seem to be just as heavily loaded with political dynamite. Thirdly, plans along these lines seem likely to lead to the creation or the perpetuation of economic blocs, involving discrimination not only in currency matters but in trade as well. Moreover, the key country in each group would be likely to exert some degree of economic domination over the others to which it supplies foreign exchange. Certainly this is not the type of solution to which most Canadians would look forward. This key currency approach may have had much to offer as a way out of the difficulties of the 1930's, but now, I think, we are ready for and capable of something better.

There is one potential danger in these currency proposals which must be guarded against. Immediately after the war we may face for a time continued dangers of inflation. Possibly these will be of an unusual variety where acute scarcities of many supplies will exist despite a possible temporary surplus of labor, because of huge deferred demands and purchasing power. In these circumstances, the sudden release of the international credit provided in these monetary plans might add greatly to the dangers of inflation and disruption. It might also lead in this period to the hasty use of these funds for relief or rehabilitation purposes, for which they are neither intended nor suitable. It may be desirable to defer during the transition period the access to some part at least of the credit facilities made available by any currency stabilization agreement.

Proposals such as I have been discussing today do not constitute the solution of all our post-war international economic problems. Indeed, one reason why they are a good starting point is simply that monetary stabilization is one of the less difficult problems, on which there is not likely to be serious disagreement. However, a solution to this problem will help us in finding solutions to others.

Remarks by the Chairman

Chairman Ransom: I doubt if any time is left for the discussion which we usually offer at the close of addresses such as we have heard today. Therefore, in behalf of the Academy, I again thank each of the speakers. I express especially to Mr. Ilsley our appreciation of his coming here from Canada, and the timely message he has brought us.

I call attention to the afternoon session in this room, to which you will be welcome; and I declare this morning session adjourned.

RECONSTRUCTING WORLD MONEY *

LEON FRASER

President, First National Bank of New York
Trustee of The Academy of Political Science

WHAT is international money? Why do we need it? How shall we reconstruct it?

Despite its pretentious ring, international money, though difficult to obtain, is not difficult to define or to understand. It is a money that will be accepted internationally as a satisfactory means of payment in transactions between peoples in different nations. To be so accepted it must be a strong and a stable money, relied upon by business and financial men in the leading commercial centers. It must be the pivot to which the currencies of the principal trading nations are attached. It can operate successfully only in a peaceful world—one in which preventive barriers to foreign trade are not the rule.

There is nothing magic about international money. We have had it before. Above all, it is not some mysterious, newly invented currency of a super-national character and of universal use—a concept so attractive to theorists. Proposals of this type are premature because they depend upon the existence of a world government and of world economic and financial unity. An artificial unit, such as a bancor, might afford a uniform accounting system. But the question in what actual money to discharge obligations would still remain. It is better to have a money that is a stable unit of account and also a serviceable medium of international payment.

Pound Sterling Cited

For a century before the world war, such a medium was at hand. Substantially, it was gold. National currencies could be quickly computed in terms of gold. Gold was and is universally in demand as a means of payment. But man was much too ingenious to rely on the cumbersome method of physically delivering gold—save on special occasions. The real international money was the pound sterling, linked to gold but managed by the Bank of England. International trade and fi-

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nance, largely expressed in sterling, cleared through London. If the clearings were not equal, the creditor would usually retain a sterling credit because he could buy with sterling what he wanted, where he wanted, when he wanted it.

The aftermath of World War I, the crises of the thirties, and the advent of World War II, has displaced sterling as an eligible international money. And the notion has been disseminated that gold is no longer internationally suitable; in part, because much gold is concentrated here in the United States. Yet we must again possess some international money in order to restore and develop expanding commercial and financial relationships between nations. Without these, talk of higher standards of living are all in vain.

How do we reconstruct international money?

Lately two plans for a global international institution to stabilize currencies have been offered. I am skeptical of both in their present form and under immediate post-war conditions because they are over-grandiose and over-simple at the same time. An international bank we should have, but it should develop out of the facts of present world finance and trade rather than out of an abstract blueprint. It must not cloak the truth that in the sphere of international trade and money the two predominant nations now are the United States and Great Britain. They are the key commercial nations, whose policies will make or break any currency stability.

Several national currencies are also connected by tradition and trade with the pound or the dollar. The first effective step toward an international money lies in an Anglo-Saxon financial understanding and not in some universal approach, which glosses over the fact that the prerequisite to international stability is internal stability. Unless sterling and the dollar reflect sound conditions at home, including therein the amount of the external debits or credits, they cannot be sound abroad; nor can there be any other trustworthy international money because so much depends upon a strong dollar and a strong pound.

Britain Problem No. 1

Certain conditions exist in Great Britain today that militate against the pound. I refer to the large volume of external financial obligations created by our ally in this joint war. After the conflict, Great Britain will constitute the world's

financial problem No. 1. In our own interest, as the principal creditor nation, we should help restore Great Britain to a position of balance in her international accounts.

Today the dollar, reanchored to gold, is the strongest currency on earth. It can serve as the regulator of international money. But the sun never sets upon the economic influence and the far-flung use of sterling. As the international money of tomorrow I propose a dollar-sterling standard to which the nations shall be invited to repair. In the first instance, Russia and China should be asked to join. The basis behind such a dollar-sterling standard would continue to be gold. The exchange rates between the two moneys would be mutually fixed by the respective governments and then protected against temporary derangements during the post-armistice transition period by the exchange controls and by the use of our ample gold stock until Great Britain is more nearly in equilibrium.

Experience might demonstrate that the exchange rate first chosen did not expedite equilibrium. Continuous consultation between the authorities would demonstrate the necessity, if any, of change, and would help shape policies that would achieve internal and external stability. These consultations should start at once. The rigidity of the old gold standard would be avoided by continued active management of the monetary mechanism with the goal of high production. But the ultimate foundation would remain gold.

The return to a modified international gold standard is easier than before the war. This struggle is rapidly redistributing gold. Today the 1943 dollar value of the gold possessed by countries other than the United States is greater than the 1929 dollar value of all the gold then in the world, including the United States. True, we still have the major portion, but the new techniques of money management require less gold than heretofore. Yet, make no mistake: we cannot have any enduring international money without discipline. Basically, each country must work out its monetary salvation by its own efforts, but America can lead by good example and by generous aid.

Outlines Agreement

With a view to reconstructing international money, we should enter into a stabilization agreement with Great Britain,

open to the adherence of other countries, which would include:

(a) A credit to Great Britain in the form of a call on gold in the amount of, say, five billion dollars, on the understanding that neither nation would engage in competitive exchange depreciation and that the dollar-sterling exchange rate would be fixed by mutual agreement. Such a credit would constitute a constructive use of some of our surplus gold.

(b) Formal cancellation of the remaining unpaid balance of the British war debts of World War I.

(c) Provision for a moratorium for a period of five years of any post-war lend-lease repayments involving transfers out of Great Britain, any repayments thereafter to be limited to the return to the creditor, of the same commodity as was shipped.

(d) An understanding that both countries would eschew economic domination and would pursue international economic policies designed to promote stability of currencies in other nations. This means that we must act like a creditor nation, encouraging imports of goods and exports of capital.

(e) An agreement to reorganize the Bank for International Settlements on a wider basis in a different situs, and to use it as a center of international monetary consultation and planning, as a common agency for the joint action of treasuries and central banks in simplifying international clearings, and for dealing with the various monetary problems of the nations as they arise, including the granting, against proper commitments, of temporary stabilization credits to smaller nations. We should build on the experienced machinery that we have instead of creating elaborate new machinery. But it is necessary to dispel the illusion that any international instrument can work miracles or bring about stable currencies in an economically anarchic world.

This proposed Anglo-Saxon agreement would be but the nucleus of a wider pact which many associated nations would join forthwith and others as rapidly as may be. It is a fertile beginning and not the ultimate goal. This program may seem modest; yet, coupled with the other necessary measures of relief and rehabilitation in the war-torn countries, and for reopening the channels of international investment and commerce, this realistic approach represents the best entry on the road toward the reconstruction of a real international money.

PART II

THE PROBLEMS OF INDUSTRY, PRODUCTION AND PRICE CONTROL

INTRODUCTION *

WESLEY C. MITCHELL, *Presiding*
Professor of Economics, Columbia University
Director, National Bureau of Economic Research
Trustee of The Academy of Political Science

I HAVE the honor of calling to order the second session of the Annual Meeting of The Academy of Political Science, now in its sixty-third year. This meeting will deal with the topic, " The Problems of Industry, Production and Price Control ", supplementing the discussion at the morning session of fiscal policies and the problem of inflation.

You have come here to hear the distinguished gentlemen, who, by attainment and position, are especially qualified to discuss the highly important themes that are noted in this program. I shall not deprive you of any time that you might more profitably spend in listening to them, but shall introduce them in the briefest possible manner.

Our first paper will be on " Canadian Problems of Industry, Production and Price Control ", and the speaker is the Hon. Hugh D. Scully, Consul General of Canada. Mr. Scully!

* Opening remarks at the Second Session of the Annual Meeting.

CANADIAN PROBLEMS OF INDUSTRY, PRODUCTION AND PRICE CONTROL

HUGH D. SCULLY
Consul General of Canada

I HAVE been introduced as Consul General of Canada and a former Commissioner of Customs at Ottawa. But I must remove from your minds any impression that my remarks at this meeting express the opinion or carry the approval of my department or the government of Canada. I trust I shall say nothing contrary to government policy, but I am speaking here as an individual, divorced from my official position temporarily. My observations may be "poor things, but they are mine own."

The subject assigned to me is "Canadian Problems of Industry, Production and Price Control". It is comprehensive. You will not expect me to cover it all in the time allotted. I can only comment briefly on some of the factors involved in the first two divisions of the subject, closing with a short report on price control.

In the calendar year 1939, Canada's total production was valued at $3,241,000,000, which had grown in 1942 to $6,176,000,000. Canada's estimated national income was $4,567,000,000 in 1939 and had grown to $7,500,000,000 in 1942. The year 1943 will show still further increases, probably about 10 per cent in both production and income.

The accompanying table from the *Financial Post* (Toronto) *Year Book,* 1943, giving a breakdown and comparison of Canada's production for the five years 1938-1942 will be of interest.

I shall pass over farm crops because the problems involved in their production and marketing stand by themselves. To the United Nations Committee on Food and Agriculture, which stemmed from the World Food Conference at Hot Springs last May, has been assigned the major task of working toward a solution of this international problem. The approach is multilateral which it has been urged should be the pattern for all

National Production of Canada

	1942 $000	Per cent change from 1940	1941 $000	1940 $000	1939 $000	1938 $000
Agriculture	1,639,156	+79.2	914,601	885,115	826,390	742,020
Forestry	467,151	+ 7.0	436,477	370,121	271,723	244,565
Fisheries	67,984	+30.1	52,063	38,107	34,379	35,593
Trapping	15,627	+ 3.2	15,138	11,208	7,919	6,573
Mining	485,392	+ .4	483,650	446,081	393,232	374,416
Electric Power	221,532	+13.4	195,270	163,781	149,864	142,321
Total Primary Production	2,896,842	+38.1	2,097,199	1,914,413	1,683,507	1,545,488
Construction	245,282	— 9.0	269,562	206,894	183,706	176,661
Custom and Repair	144,919	+ 9.7	132,100	110,745	96,652	99,086
Manufactures	3,534,927	+24.5	2,838,364	1,942,471	1,531,052	1,428,287
Total Secondary Production	3,925,128	+21.1	3,240,026	2,260,110	1,811,411	1,704,034
Less Duplication [a]	645,134	+26.0	511,789	350,846	253,787	274,847
Net Value of Industrial Production	6,176,836	+28.0	4,825,436	3,823,677	3,241,131	2,974,675

[a] Manufactures Total includes duplication with Primary Group.

international trade agreements. But it must not be forgotten that there has been a heavy increase in production, notably in hogs, beef cattle, many of the grains and in some miscellaneous items of farm produce, notwithstanding the decline in manpower on the farm. The tenacity of the farmer in conducting his operations under wartime handicaps is noteworthy.

Canada depends on export markets for her agricultural products. An outlet for this additional production must be secured. Orderly marketing in conjunction with other nations seems the only solution. There has been little if any increase in capital investment on the farms during the war in sharp contrast to what has occurred in the factories. So we are relieved of anxiety on that score. I shall confine my remarks largely to the problems of industrial production which include processed farm products.

The tremendous increase in the volume and value of Canada's manufactures has surprised our own industrialists, economists and the government. From a war supply standpoint it has been highly satisfactory and reflects great credit

on all those who have had a share in its planning and execution. To make it possible there has been a heavy increase in capital investment, consisting largely of advances from the government. These will have been amortized substantially by the end of the war. The huge industrial machine that Canada has built up so quickly in the past three years is all tuned up to carry on.

It all poses the problem of markets after the war. Taking up the slack in the domestic market will occupy part of it for a while, particularly in consumable and non-durable goods, but it is not the whole answer for two reasons:

1. Much of the equipment that has been set up is of a specialized character, not suitable for the ordinary articles of commerce at all, or vastly in excess of the demand in peacetime for the specialized products it can turn out.

2. Substantial additions to the pre-war productive capacity of many industries making consumer goods which were also in heavy demand by the armed forces can take care of much greater domestic demand than would normally be available with our existing population.

It appears that Canada will be greatly overindustrialized at the end of the war. Organized labor, our Manufacturers' Association and Chambers of Commerce are already exercised about maintaining continuity of production in the switch from war to peace operation of our new industrial machine.

But let us beware of overstating this problem. The great new machine has been running two or three shifts night and day for nearly three years. Is it proposed in Canada or anywhere to operate on that scale after the war? When we taper off to one normal shift, the problem is probably only half as big. Those who talk freely of "full employment" after the war should define what they mean.

It is assumed in some quarters that the present Canadian tariff must be maintained with possible additions and increases if we are going to attempt to operate our wartime industrial acquisitions. Others feel that such time-worn remedies are out of joint with the times. Without passing on these conflicting points of view doubt exists in many minds that we could operate successfully on a substantial scale the whole of our new

industrial capacity under any system. Apart from the domestic political considerations involved, it would throw too big a strain on our national economy and should be avoided except as a last resort. International planning and agreement seem essential if we are going to avoid the pitfalls of such a policy.

The other obvious solution is export trade. There is no patentable novelty in this suggestion. Every allied nation is talking and planning increased export trade, and, if peace should descend suddenly upon us, the disorganized scramble for a share of the world's markets would be not only confusing but far from constructive.

Not that the quantity of export trade is frozen. It is fluid. It can be expanded. But not overnight! It will take time and planning on a grand scale to increase purchasing power in countries with low standards of living to the point where it is reflected in global export trade returns.

An immediate attempt to work out the principles of the Atlantic Charter and to live up to the pronouncements of the great national leaders on the Allied side seems abundantly indicated. Unless we proceed to implement these principles of agreement by practical planning on the broadest possible scale, not one of the individual nations is going to be able to maintain a sound economy after the war.

There are foundations on which to build. Since 1935 Canada and the United States have enjoyed mutually the advantages of the Canada-United States Trade Treaty. While originally a bilateral treaty, provision was made for its extension, in whole or in part, to what are known as favored nations. United States and Canada have since entered into trade arrangements with many other nations under this proviso.

All international trade negotiations inevitably involve the tariff problem. What is Canada's tariff position today? In 1939 the ad valorem incidence under Canada's customs tariff on dutiable items was 24.2 per cent as against an average under the United States tariff, on the same basis, of 37.33 per cent. The ad valorem incidence on total imports (free and dutiable) was 13.8 per cent for Canada as against 14.41 per cent for the United States.

Opinions differ widely as to element of protection in the present Canadian tariff but the over-all incidence had declined

steadily in the years preceding the war from a high on dutiable goods of 30 per cent and an over-all of 19.1 per cent, in 1932. It is true that since the outbreak of war, Canada in order to meet the impact of foreign exchange disruption has had to adopt abnormal measures in tariff and taxation. The first of these arose out of the necessary measures adopted by the Foreign Exchange Control Board in September 1939 to ensure that we would be able to pay for the vastly increasing quantities of machinery and material which we found it necessary to buy in the United States to start our war production efforts on a suitable scale. The exchange rate was fixed by the Board, and, without elaborating all the details, every invoice of United States goods was advanced 11 per cent when converted into Canadian currency and the Canadian tariff and sales tax were applied on this premium.

Then in June 1940, with a view to conserving hard currency, of which our supply was painfully low, a war exchange tax of 10 per cent was levied on all importations from hard currency countries, and luxury taxes were imposed on certain non-essential imports, thus pyramiding further the tariff and sales tax incidence on imports from the United States.

Another factor that disturbed our normal trade relations was the War Exchange Conservation Act of December 1940, which prohibited the importation from hard currency countries of a substantial list of goods. The burden of these various measures against your exports (other than war goods) to Canada has been eased during the past few months by exemptions and by the payment of subsidies to the importer under the Wartime Prices and Trade Board regulations.

Those who have made a close study of the matter have concluded that the present formula under which your President may negotiate reciprocal or favored nation treaties by conceding reductions in the United States tariff up to 50 per cent of the existing rate is nearing exhaustion with respect to Canada. If the United States tariff rate is so high that its reduction by 50 per cent still protects the United States producers so that no goods may enter from Canada, no increase of trade results in the items in this category. On the other hand, it has been held by many United States exporters that what is

known as the British preferential tariff system, first embarked upon by Canada in 1897 and enlarged on several occasions since, makes it impossible for them to get that part of the Canadian market for which the Canada-United States Trade Treaty seemed to hold out a promise. Hark the California raisin grower who faces his Australian competitor under the British preference!

Such representations suggest consideration of a new or revised formula in the negotiations in which our two countries must shortly engage. Doubtless proposals for a widened application of the quota principle and the extension of British preferential rates in whole or in part to favored nation countries will be submitted.

It has also been suggested that a study should be made of the production of certain classes of goods in which Canada is proficient and competitive to the end that such goods might be given reduced rates or free entry under the United States tariff. In return it is proposed that Canada might agree not to encourage by tariff measures the production of certain goods which the greater volume producers in the United States could supply at a much lower price than is possible in Canada.

Such suggestions will undoubtedly be viewed with alarm in both countries. But we are approaching a stalemate under our present basis of negotiation. Constructive new ideas must be entertained and analyzed even if they involve reciprocal trading of tariff items on a block basis.

But relief from prohibitive tariff rates, while hitherto the major concern of trade negotiations, is only part of the problem. When these are removed or eased by agreement, the participating nations and nationals in the respective countries must prepare themselves for an invasion of their economic souls by a new spirit. The full advantages of agreements are never realized by lowering rates or establishing quotas if the old *shut-out* policy still lingers in administration. And so we come to the doors of the customs house. What happens to a shipment of goods when it reaches a port of entry in either country? It has to face classification and appraisal. Here I quote in part from the principal appraisal sections in the United States and Canadian customs laws, respectively:

UNITED STATES (Section 402)

Foreign Value: The foreign value of imported merchandise shall be the market value or the price at the time of exportation of such merchandise to the United States, at which such or similar merchandise is freely offered for sale to all purchasers in the principal markets of the country from which exported, in the usual wholesale quantities and in the ordinary course of trade, including the cost of all containers and coverings of whatever nature, and all other costs, charges and expenses incident to placing the merchandise in condition, packed ready for shipment to the United States.

CANADA (Section 35, Customs Act of Canada)

Whenever any duty AD VALOREM is imposed on any goods imported into Canada, the value for duty shall be the fair market value thereof, when sold for home consumption, in the principal markets of the country whence and at the time when the same were exported directly to Canada.

There are numerous provisos and regulations that supplement these major sections in both acts. All are defensive and establish procedure for investigation of values and the fixing of higher values more or less arbitrarily if such action is considered warranted. It is generally agreed by those competent to express an opinion that these sections of the respective acts do much more than protect the revenue, granted that this is a prerequisite of all customs administration. It has been alleged that both countries, and they are not alone, have used and do use these sections to restrict and in some cases prohibit the entry of goods.

United States pioneered in the policy of protection for domestic industries during the nineteenth and twentieth centuries. The administrative practice of the United States in carrying out this policy has become a standard for the world. Canada has been an apt pupil. Other countries have not lagged far behind when necessity urged. The law and practice of both Canada and the United States with respect to the appraisal of goods for customs purposes are based on the old simple structure for the distribution of merchandise that prevailed in the nineteenth century: producer or manufacturer—to wholesaler—to retailer—to consumer.

But a great change came over merchandising methods about the beginning of this century with the advent of departmental stores, mail order houses and chain stores. The result was the

elimination of the wholesaler altogether in some lines and the scaling down of his importance in the whole merchandising structure. More recently wholesale distribution has been affected by the taking over, by what have come to be known as national distributors, of entire factory outputs.

Prices and discounts are determined by the value of the customer to the manufacturer: after weighing such factors as the quantity purchased; whether for cash or on short terms; and elimination of credit risks involved in selling a large number of local distributors.

Inevitably buying power was concentrated and resulted in lower prices being quoted by the manufacturer to those agencies of distribution which relieved him of a large part of his selling costs. But the customs authorities have not changed their practice to suit these new methods. Values for duty are still fixed at the level of the highest prices to the smallest volume distributor in the home market of the exporter.

If the government in the receiving country is favorable to a protective policy, the customs administration operating within the letter of the law may fix the value at the highest value, even if it represents the lowest volume of sales. This has been in fact the practice in both the United States and Canada and has been the occasion of many protests from exporters in both countries.

Traders in both countries have urged that consideration be given, and legislation enacted if necessary, for the establishment of a system of customs administration which will permit acceptance of the prevailing home market price for each class of the exporters' trade if the importer belongs to the same class in the country of import. Canada has made some approach to this end, particularly since the first Canada-United States Trade Treaty which came into effect on January 1, 1936. Canada felt that not to move in this direction was a failure to recognize the change and trend in modern distributing methods and resulted in an artificial level for the assessment of duties and taxes which was far removed from the actual competitive conditions in the country of export.

In any international agreements made with respect to tariff rates should there not also be an agreement on the method of appraisal within certain well-defined limits? If one nation has

a law which enables it to levy treaty rates on the highest market price prevailing in the country of export and another nation determines the value at a discount of 20 per cent under like conditions, business will be one-sided and friction will result. For example, if Canada levied duties and taxes on the dealer price of agricultural implements and did not recognize the factory branch or national distributors' discounts in the United States, she would block or hamper a considerable portion of the exports of such implements to Canada.

This is the major administrative issue that those who are responsible for the negotiation of trade treaties should keep in mind. A uniform policy in the determination of values must be agreed upon if the rates of duty are to be applied equitably under the treaties.

But there are other important factors that merit consideration by trade treaty makers. I will mention a few very briefly.

1. Goods presented at customs must be dealt with in the most expeditious manner possible. If a shipment of goods is held up unreasonably pending an investigation of the fair market prices in the country of export, or on other technical grounds, that particular transaction is voided and future business is doubtful.

2. Marking legislation must not be used as concealed protection. Granted that the purchaser of goods in the importing country has a right to know in what country the goods he purchases are made, shipments should not be refused entry, unduly delayed, or penalized if they conform with the spirit of the legislation. For example, it would be considered unreasonable if Canada rejected a shipment of books that bore the imprint of a well-known publisher in New York City on the ground that they did not bear the specific imprint required by the law " Printed in the United States of America " or " Made in the United States of America ". Cases of this kind are continually cropping up in customs administration.

Fraudulent evasions of the marking regulations such as were practiced, for example, by Japan for many years should not be condoned. These should be punished by the rejection or condemnation of the goods and the fining of the importer. A few examples of this kind soon put a stop to such practices.

3. There should be a simplification of the wording and some approach to uniformity in the definition or content of tariff items. The League of Nations made efforts to this end. It is a long, tedious job, but might it not be possible to make some progress by defining at least some of the items embraced in multilateral trade treaties which will be entered into after the war in the same words? Anyone who has studied the tariffs of the various countries cannot fail to see that they are full of complexities in wording and classification to the point of confusion. Obsolescences, ambiguities and inconsistencies abound. The adoption of uniform wording would go far to reduce the number of items in the customs tariffs of the world. Also it would remove a great many " fancy " items which represent split-offs from main items conceived to take care of some special interest under special conditions.

To make such a proposal may sound like impractical idealism to those hardened in present customs terminology and procedure, but, without counseling perfection, I do seriously suggest that some practical progress could be made in this direction in the next trade treaties.

4. Simplification of Customs Documents — Everyone who has had to do with customs and tax administration, whether on the paying or receiving end, must from time to time feel completely bewildered by the vast numbers of papers that have to be filled out, signed (in many cases most perfunctorily), recorded and filed, before the goods can move to the importers' shelves. Many of these forms duplicate each other. Surely it would be possible for intelligent administrators with the assistance of intelligent traders and transportation experts to consolidate, and thus reduce, the number of pieces of paper that have to be worked before goods can move from one country to the other. All shipments start with a bill of lading which contains practically all particulars necessary for the moving of the goods and, I submit, the levying of duties and taxes thereon. Is it not feasible that the declarations required by customs laws could be indicated by the signatures of the exporter and importer somewhere on the bill of lading and that similarly, where consular documentation is required, the consular official sign somewhere else on the document? This would mean one piece of paper instead of three and, while the forms might

have to be slightly enlarged or rearranged, it does seem to me that it is possible to make some progress in this direction. This would seem a fitting subject for Chambers of Commerce, Boards of Trade and Customs Brokers Associations to work on and discuss with appropriate government officials.

Now there are undoubtedly many other minor irritations involved in the passage of goods from one country to another, but, I think, I have indicated enough for one time. They can be used together or separately as methods of concealed protection. It seems to me that if we are going to attain the maximum advantages from treaties and promote and ensure goodwill we must have a change of heart and mind to foreign goods entering the country. The time has come for wider vision, greater imagination.

A few weeks ago the *Ottawa Journal,* generally regarded as a Conservative and protectionist paper, summed up the new attitude toward the tariff in relation to international trade as follows:

> We have no patience at all with the doctrinaire people who keep telling us that tariffs are out, that in our coming "brave new world" customs offices will be unknown; this country is not going to batter down its tariff walls for the gain of countries like Japan. But equally hard is it to have patience with manufacturers and politicians who seem to think that a country can always sell and never buy; who keep proclaiming with one breath that the economic salvation of Canada is in "world markets" and in the next breath that we must reduce imports.
>
> Goods are paid for with goods; that is the ABC of trade. Therefore, if this country is going to have world markets—and it must have world markets—it must be prepared to import goods from world markets. We can't just decide to sell things to China without taking things from China in payment; or sell goods to South America without taking goods from South America. The idea that we can, that by some magic we can have exports without imports, belongs to economic illiteracy.

I have tried to indicate some of the factors that enter into the problem of better trade relations. The *time gets shorter.* If peace came suddenly, we would have to carry on under existing trade conventions and treaties which we are all agreed are inadequate and which have only a short time to run. Neither Canada nor the United States can settle satisfactorily the problems of industry and production except in some form of multilateral convention which will make possible to some degree the

orderly marketing of the products which the industrial machine we have set up under war conditions is capable of turning out. If peace arrives without these treaties or conventions having been agreed upon, trouble and confusion are inevitable.

Price Control and the Stabilization Policy

The enormous acceleration of Canada's war effort which took shape after Dunkirk, and which is now absorbing more than 50 per cent of the resources and manpower of the Canadian economy, made it necessary for the government to embark upon a series of economic controls which we in Canada describe as the Stabilization Policy. Price control is perhaps the most striking feature of this policy, but, of course, it does not stand alone.

The necessity for an orderly and equitable approach to the problems created by the shift to war production was recognized in the first Budget Statement, made within a few weeks of the outbreak of war in September 1939, which announced the intention of financing war expenditures so far as possible on the "pay-as-you-go" principle. Since then, fiscal controls have been followed by the institution of controls over prices and rents, profits, wages and salaries, and by controls over the supply of civilian goods and services and over manpower. Taken together these controls are intended to achieve the following purposes:

First, to promote an efficient war effort and to facilitate the diversion of production to meet the need for war materials; second, to prevent a threatened drastic increase in prices, and the cost of living; and third, to distribute the real burden of the war program, so far as the home front is concerned, as fairly as possible between all groups in the community in accordance with some test of economic ability.

Like your Administration, the Canadian government believes that the war program would be endangered by the economic confusion that would be created under inflation. Moreover, taxation and borrowing are the proper instruments for distributing the burden of war costs. Inflation, on the other hand, operates as an inequitable and demoralizing tax on almost all incomes.

Finally, but not least in importance, stabilization in wartime will help to create an environment which is at least not unfavorable to an orderly transition to peace, when victory is won.

The need for such a stabilization policy is emphasized by the present scope of Canada's war program, and by the resultant upward pressure which this exerts on prices, wages and costs generally. The relative magnitude of the war program can best be gauged by reference to the growth of war expenditures. The Dominion government's estimated expenditures for the current fiscal year (ending March 31, 1944) are about five and a half billion dollars, a tenfold increase since 1939. This figure of $5½ billions represents rather more than 50 per cent of the total value of all production in Canada, or, as the economist describes it, the gross national product.

I may add that the national product itself has virtually doubled since 1939. On the manpower side, the size of the total working force, including the armed services, has increased by 28 per cent. The number of people engaged in manufacturing has just about doubled, rising from 650,000 before the war to over 1,300,000 today, while the number of men in the armed services has risen from virtually zero to about three quarters of a million. I should add here, perhaps, in using any figures with respect to Canada, that you must remember that we are a population of about 11,500,000 people, in an area larger than the United States, as against your 130-odd million, so that you have to do your own multiplying to get the comparisons.

What these economic aggregates suggest, then, is the obvious development—common to both our countries—of a vast expansion of production, mainly of a wartime nature, an enormous increase in purchasing power in the hands of ordinary people, a critical shortage of manpower, and a rising pressure on a diminished supply of civilian goods and services. Taken together, these trends suggest that inflation would be a reality were it not for the adoption of strong anti-inflation controls.

The battle for stabilization has to be fought on many fronts and defeat on any one front would threaten the entire campaign. For example, one of the principal fronts is price control. It is now more than two years since the government of Canada

launched upon a policy of an over-all ceiling on the prices of commodities, services and rents. Judged by the results—a 4 per cent rise in the cost of living—this measure has so far been fairly successful. But it could not have succeeded were it not for the parallel ceiling on wage rates, instituted at the same time, and were it not for the fact that the government has drained off excess purchasing power by a very stiff program of taxation and by a series of impressive Victory Loan campaigns.

As we see things in Canada, and I know that thinking in this country follows a similar pattern, you cannot prevent prices from rising if the principal cost of production, namely, wages, continues to rise. Nor can you effectively control prices and prevent black markets if the active purchasing power in the hands of the people is far in excess of potential supplies of goods and services. Canada's wage and salary controls, therefore, support the battle for a stable cost of living on one front; the drastically increased taxation and borrowing policy does likewise on the other.

So far as the wage ceiling is concerned I should point out one significant difference between the Canadian and American arrangements. In Canada the wage ceiling is accompanied by a system of mandatory cost of living bonuses payable by every employer. These bonuses are adjusted quarterly in accordance with changes in the wartime cost of living. In view of this obligation it will be recognized that any increase in the cost of living tends to be self-aggravating, in the sense that it automatically adds to the wage cost of production in industry, and to that extent reinforces the needs of manufacturers for higher selling prices. As a matter of fact, this dilemma led to a significant development in price control last December, when the government decided to subsidize the consumer price of certain basic foods, namely, milk, oranges, tea and coffee. This step was taken to offset the effect of an increase in the prices of foods, and hence to prevent an increase in the cost of living, which would have required increased cost of living bonuses and hence paved the way for further price increases.

Aside from this advantage, this measure was also a recognition of the fact that the cost of living bonus system does not protect every consumer from price increases, and that a subsidy on foods has the effect of increasing the real income of the low

wage groups in the community at the expense of those who can afford to pay the taxes required to support the subsidy.

Speaking of taxes, the stabilization policy, as indicated above, has involved a drastic extension of fiscal controls. The chief features of this development have been (a) the extension and streamlining of the personal income tax; (b) an increase in corporation profits taxes and the adoption of a 100 per cent excess profits tax, with provision for a 20 per cent post-war rebate; (c) an attempt to mop up all possible excess purchasing power left over, after taxes have reached the point of maximum effectiveness, by an aggressive borrowing compaign. Actually, we are covering about 50 per cent of total federal expenditures by taxation.

In the case of the personal income tax Canada led the way by placing the collection of the tax on a more effective and fair basis by the introduction of a system of deductions at the source, and—through the cancellation of half of the 1942 tax debt—by relating tax payments to current income. Another phase of the fiscal program has been the adoption of a system of compulsory savings as part and parcel of the income tax system. This plan makes compulsory a moderate amount of savings, but allows the taxpayer relief from this returnable tax if he is already encumbered by the required amount of savings obligations in the form of insurance, mortgage payments, and the like.

The severity of the increase in tax collections may be demonstrated by one or two illustrations. A single person with an income of $1,500 per annum in Ontario would have paid $22 in tax in 1938; today a man with the same salary would pay $367, of which $120 would be returnable after the war as the compulsory savings portion. A married man with two children and earning $5,000 before the war would have paid $118. Today the same man would pay $1,662, of which $600 would consist of compulsory savings.

I emphasized the importance of wage and fiscal controls because of their importance to the effective working of the price ceiling. But the administration of price control has not been lacking in problems of its own. Some of them have been problems of administration; others—and much the more intractable—have been economic problems. Since we in Canada plunged

into the experiment of an over-all price ceiling some six months ahead of the United States, the difficulties which faced the Wartime Prices and Trade Board have almost invariably reappeared a little later to plague the Office of Price Administration. In many cases these two administrations have been able to consult together to their mutual advantage, and to profit from the experience of the other.

The most serious and continuous obstacle to the stabilization of prices has been the upward drift of costs of production. From the very beginning there was the problem of maintaining fixed selling prices in spite of rising replacement costs. Labor costs have risen as a result of greater labor turnover, the use of less experienced help, and so on. Materials today are more costly because they have to be transported over longer distances, or are subject to higher shipping charges.

To meet the difficulty of rising costs we have adopted the expedient of "sharing the squeeze", whereby producers, wholesalers and retailers share the increased costs between them. Continuous efforts have also been made to reduce costs by simplification measures and by the elimination of unnecessary frills and services. When these alternatives have been exhausted the government has sometimes used the device of subsidies to prevent an increase in the final price of both domestic and imported goods.

Dealing first with import subsidies—as you know, Canada in peace and war is more heavily involved in international trade than the United States. Consequently the increase in prices in the United Kingdom and the United States—particularly in the latter, which is the single largest external supplier for Canada—has complicated the problem of maintaining the domestic price ceiling.

The Wartime Prices and Trade Board could "roll back the squeeze" as far as the Canadian-American border, but its jurisdiction stopped short at that point! When the continued importation of the article in question was deemed essential, and it proved impossible for domestic manufacturers and distributors to absorb the squeeze, the Board has paid the subsidies. In fact, import subsidies accounted for about half the total subsidies paid in the last fiscal year. In addition or as an alternative to a subsidy, import duties have been reduced

or suspended. In some cases the Dominion government has also found it necessary to bulk-purchase certain imported materials so as to ensure adequate supplies and to maintain the price ceiling, with the government assuming the burden of any trading losses involved.

Subsidies on domestic production are paid through the Wartime Prices and Trade Board and through the Department of Agriculture. In some cases, and particularly in regard to certain farm products, it has been necessary to pay subsidies to maintain production in the face of rising costs and labor shortages. For example, subsidies are paid to farmers on deliveries of fluid milk and butterfat to processors and distributors. To keep down farm costs directly, subsidies are also paid, for example, on fertilizers, protein feeds, binder twine, or to reduce transportation charges on feed grain moving from the Prairie Provinces to Eastern Canada.

The Canadian government has not hesitated to use the subsidy technique, because there have been occasions when there was no other way of preventing advances in the price of important commodities. It should also be emphasized, however, that subsidies are regarded as the last—and not the first—approach to the solution of such problems, and that every subsidy demand is a matter requiring the closest scrutiny. Many of our subsidy agreements also embody arrangements for profit control.

The theory behind the subsidy approach is that while subsidies have an element of inflation embodied therein, the alternative of a rise in price or a curtailment of supply is far more inflationary. Since a seemingly small rise in price so frequently leads to a cumulative series of further price increases, it has been found that the payment of a subsidy at one point in the production process may avoid a much more serious inflation of prices than any alternative form of economic therapy.

The subsidy budget of the Wartime Prices and Trade Board for the current year has been set at $120 millions. In addition there are certain wartime subsidies paid to agriculture, associated with the stabilization policy, and applicable notably to butterfat and other dairy products, or payable to millers to compensate for the increased cost of wheat. These expenses should be set against the very great although non-measurable

savings to the Treasury and to the consumers of Canada achieved by the avoidance of a general rise in prices.

An essential part of the system of price control is, of course, the control of supplies and their distribution. Without plans for the assurance of a reasonable supply of essential goods and services, and a system of equitable distribution, price control would be ineffective. It would take too long to survey the procedures adopted to control civilian supplies. In any case the general approach to this complex of problems is essentially similar in both our countries. The differences are explainable largely in terms of the special requirements of the Canadian scene. It might be pointed out, for example, that in Canada the same agency is responsible for both the production and distribution of civilian supplies, as well as for their pricing. Consequently the administration of plans whereby the allocation of raw materials has been tied in with the production of essential types of consumer goods, and with the pricing arrangements involved, has been simplified.

The problem of equitable distribution of goods in short supply is tackled by arrangements worked out between the Wartime Prices and Trade Board and the various manufacturers, wholesalers and importers concerned. In brief terms, the basic policy requires all suppliers to distribute goods in short supply to their customers in proportion to their sales to such customers in 1941. Starting from this point adjustments are authorized to deal with special cases—shifts in population, new businesses started since 1941, unexpected demands from the armed services, the Red Cross, and the like.

So far as coupon or permit rationing is concerned, differences in the consuming habits of Canadians and Americans, or differences in the basic supply situation, make inevitable certain differences of detail or of emphasis in the rationing schemes of the two countries. Canadians drink a good deal of tea though rather less coffee than you do; we have to ration both, you had to ration only coffee. The United States rations shoes, while Canadians—who do not wear out as many pairs of shoes per person as your ration allows—have not been subject to rationing.

The effectiveness of Canada's stabilization policy may be measured, as I suggested earlier, by the moderate increase

shown by the cost of living index, which has risen by about 4 per cent over the last two years, as compared with a 15 per cent increase in the two wartime years preceding the ceiling, when the basic inflationary pressures were much less serious.

But it would be foolish to pretend that the danger of inflation and instability has been removed. The upward pressure on prices and costs has been steadily increasing.

The main difficulty stems from the acute shortage of manpower and supplies in relation to the demand, which has increased the bargaining power of almost every economic group in the community. In these circumstances it is human nature for each group to think that its own problems call most for redress, and to forget the fact that at a time of full employment such as exists today no one group can improve its economic position except at the expense of the rest of the community.

In this connection, the biggest danger to the price ceiling naturally comes from the possibility of higher wages and higher food prices, since these together constitute the bulk of the costs which go to make up the cost of living.

Public support for the price ceiling and for the principles of the stabilization policy has been widespread. It is my belief that the Canadian people will continue to exercise those qualities of self-discipline which have stood us in good stead so far, and which are necessary if each separate group is to subordinate its own apparent self-interest to the real interest of the whole community. In this way we shall win the battle on the home front, and speed the victory over our common enemies overseas.

REMARKS BY THE CHAIRMAN

CHAIRMAN MITCHELL: Our second speaker, who will discuss "Industry's Transition from War to Peace", is Dr. T. O. Yntema, Director of Research for the Committee for Economic Development, and Professor of Statistics at the University of Chicago. Dr. Yntema!

INDUSTRY'S TRANSITION FROM WAR TO PEACE

THEODORE O. YNTEMA
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Professor of Statistics, University of Chicago

THE transition of industry from war to peace will have three overlapping and closely related phases:

1. The demobilization of war production and the armed services, i. e., the release of resources from war employments;
2. The expansion of the production of civilian goods and services;
3. The removal of wartime controls, such as price ceilings, allocation and rationing, and the return to a system in which prices are free to respond to unrestricted changes in demand and supply.

I should like to focus attention on the larger aspects of these processes, to give some indication of the magnitudes involved, and to point out the conditions critical for a reasonably good solution of the transition problem.

We shall get a better perspective, if we look at the war economy in its immediate historical setting. The decade before the war was a period of industrial stagnation. From 1931 to 1940 the average level of unemployment was 20 per cent of the working force, and in no individual year did unemployment average less than 8½ million persons, or 16 per cent of the working force. During the depression of the thirties we lost more than 200 billion dollars of potential production of goods and services because men and machines did not have work. We organized relief on a large scale; we fostered a tremendous concentration of economic power in labor unions and farm organizations; we inaugurated social reforms (many of them badly needed); but we made little progress toward

[1] The Committee for Economic Development, with which the writer is associated, has no responsibility for the judgments and opinions expressed in this paper.

solving *the* economic problem of our time. By 1940 we had almost forgotten what a high level of production and employment was, and many of us thought it could not be attained again in the United States.

Then came the war and with it insatiable demands for munitions and men. Now we are almost on a full war footing: there are 52,000,000 persons in civilian jobs and there will soon be 11,000,000 persons in the armed forces, a total of 63,000,000 persons employed. That is 16,000,000 more than were employed in 1940; and 1940, by pre-war standards, was a good year. Even this understates the increase in employment since it takes no account of the substantial lengthening of the work week. All told, we have freed 11,000,000 persons for the armed forces and increased the aggregate hours worked by civilians by some 25 per cent. At the same time tremendous industrial, occupational and geographical shifts in employment have been required to make possible the diversion of half our production for war purposes.

The methods by which this mobilization for war was accomplished are worth noting since they will determine in part the steps which must be taken in demobilization. From the first, the government has been using new money, created by its borrowings from banks, to finance a substantial part of its war purchases. Thus, the aggregate demand for goods has exceeded the supply at current prices. This excess demand has drawn idle resources into production but it has also exerted an upward pressure on prices, necessitating price and wage controls to prevent a runaway inflation. These controls in turn have made prices ineffective as a means of distributing goods among consumers and of allocating productive resources to most essential uses, and we have been forced, therefore, to resort to rationing of consumers' goods and to administrative allocation of materials and productive resources. In qualification of these statements it should be recognized that even without large inflationary pressures many direct controls of prices and production would have been required to prevent excessive profits and to expedite the shift of resources into war production. Nonetheless, government buying with newly created money has greatly extended the areas in which administrative controls of our economic system have become necessary.

Quite incidentally, deficit financing and price ceilings have brought into being a potent force to be reckoned with in the transition from war to peace. Because the incomes of individuals have been so far in excess of what they could spend, their savings have been enormous. This year they will amount to some 35 billion dollars,[2] most of which will take the form of increased holdings of money and government securities. Businesses likewise have become more liquid, although for somewhat different reasons. Cash and governments held by non-financial corporations have been increased in large amounts by ploughing back of profits, by inability to make expenditures for maintenance and replacement of equipment, and by reduction in inventories, as well as by increases in tax liabilities and debts to banks. While these mounting liquid resources constitute a threat of inflation, they will also afford protection against a deflationary collapse when government spending declines.

The transition from war to peace will be much affected by the duration of the war and by the timing of its conclusion in Europe and in the Pacific. The longer the war lasts, the greater will be the distortions, and the harder it will be to make the shift to a peacetime economy. If the war ends on both fronts simultaneously the transition will be sudden and the changes involved will have to be made rapidly. If, on the other hand, as now seems likely, the war with Germany ends first, while the war with Japan continues, demobilization and conversion will take place more gradually. The conclusion of hostilities in Europe will reduce the purchases of munitions and supplies for our ground forces to a comparatively low figure, and as a result total war expenditures may drop by as much as 50 per cent. This will free some materials and labor for civilian purposes and will make possible a partial demobilization of the army. It will also raise the perplexing question, "Who obtains the limited supplies of materials and the opportunity to get back first into civilian markets?" The answer to this question is apt to be difficult and embarrassing, because there are no obvious criteria on which to base it. The answer is also likely to be important in determining whether new firms will be able to enter an industry. But we can probably muddle through the first phase of partial demobilization without seri-

[2] Including savings of unincorporated businesses.

ous trouble. We shall still have deficit financed government buying and an excess of demand over supply which will draw idle resources quickly into civilian production. Although it will be possible to relax some of the restrictions on production and consumption, we shall still have to retain the general pattern of wartime controls.

When hostilities with Japan as well as with Germany have come to an end, we must release all fighting men, workers, plants and goods no longer needed for military purposes and make these resources available for transfer to civilian employments as soon as possible. This means quick but orderly action to demobilize the armed forces, to cancel and settle war contracts, and to remove practically all limitations on civilian production. The extension of war contracts to " make work ", and the extension of compulsory military service to keep men out of the labor market, will not only slow up the transition to a peacetime basis and waste resources on useless activities, but they will do serious injury and injustice to those who are deprived of the chance to compete for the choice opportunities in the early stages of conversion. I am confident that the popular demand will be overwhelming for the discharge of men who " want out " just as soon as their services are no longer required in the army and navy. I hope equally good sense will prevail against using war contracts as a means of extending relief to communities and groups left stranded by the termination of the war.

There are, of course, innumerable problems, of both policy and procedure, in the demobilization of the armed forces, the liquidation of war production, and the removal of limitations on civilian production. When men are mustered out of the army they should receive unemployment compensation while seeking work; they should be provided special opportunities to continue their education—general education at lower levels and specialized studies at higher levels; and they should be given aid in discovering their special abilities and in finding a job suitable for them. In the cancellation of war contracts arrangements should be made for goods which are nearly completed and which will have some future use to be processed to completion. And the government should stand ready immediately with contracts for its early future requirements for mili-

tary, rehabilitation, and other purposes. Obviously canceled contracts must be settled with utmost dispatch to avoid tying up working capital of businesses needed for conversion of plant and rëemployment of workers. In the disposal of government-owned facilities it is important to decide as soon as possible which plants are to be kept as stand-by capacity for future military contingencies and which are to be available for conversion to civilian uses. Arrangements for the sale or lease of these plants should be worked out so as to avoid prolonged negotiations after the war. All these matters involve problems of government organization and procedure which, if decided before the end of the war, will enormously facilitate the conversion of industry from war to peace. While the country is engaged in an all-out war effort, the least its citizens are entitled to is assurance that adequate steps are being taken now to develop the plans and procedures which will avoid needless unemployment and distress when the war is over. Much has been done in this respect; much more is needed.

When the war is over there will be little or no reason to continue limitations on civilian production, allocations of materials or restrictions on the mobility of labor. With few exceptions, these restraints can be removed immediately. In the case of price control and rationing, however, the problems are much more complex and the timing much less certain. These controls are necessitated mainly by inflated demand which is in excess of supply at prevailing prices. How large will this excess demand (if any) be after the war? That will depend on the magnitude of the government deficit or surplus and the desires of individuals and businesses to cash their government securities and to use their money balances to buy goods. The relative magnitude of the excess demand will also depend on the rapidity with which civilian output is expanded. Some persons predict that the net effect of these factors will be an even greater inflationary pressure on prices than during the war; others expect a sharp depression and deflation. These conflicting forecasts point to the need for a comprehensive, flexible policy, adequate to deal with all contingencies. Such policy would call for the removal of price control and rationing in any area where demand and supply were balanced at or below the ceiling price. If a general deflation should occur,

most price and rationing controls could, therefore, be lifted at once. On the other hand, if the demand for goods should exceed the supply at ceiling prices after the war, the problems of control would be more complicated and also infinitely more important for the success of the transition from war to peace. Wise policy would contemplate the temporary use of the excess demand to draw idle resources into the production of civilian goods. It would also permit such increases in the prices of civilian goods as were essential to induce expansion of output. Finally, it would look to the reduction of the inflationary pressures by taxation and curtailed government expenditures adequate to achieve a budget surplus or else by a gradual rise in prices. A rational policy to control inflation will, however, be impossible if labor demands and obtains rapid increases in wage rates, or if the public kicks over the traces on rationing. Even in these contingencies, the shortage of food may be sufficiently acute to make rationing of it inescapable for the first year after the war.

In the transition period many millions of war workers and fighting men will lose their present jobs. Some will find new positions immediately, but it is not likely that civilian business can be expanded fast enough to employ all, or even substantially all, those who will be looking for work in the first few months of peace. This situation will be complicated by the industrial, occupational and geographical shifts which many workers will have to make. These men who have done our fighting and our war work are entitled to help in finding jobs and to liberal compensation while unemployed in the first six months or year after the war. In these matters the states and the federal government should compromise their differences and coöperate in developing an adequate program of employment service and unemployment payments. In addition, a large shelf of useful public works, which can be started and terminated quickly, will help to tide over this period of inadequate employment opportunities.

The special problems of demobilization and reconversion are important but, all together, they are of less significance, even for the post-war transition period, than the normal, peacetime problem of providing the essential conditions for the expansion of business and the maintenance of reasonable stability at high

levels of activity. We failed dismally to solve that problem before the war; if we fail again we cannot possibly make a successful transition to peace.

Our crying post-war need will not be reconversion, but expansion. If we reconvert to pre-war levels of production 15 million people will be out of work. To realize the possibilities of our productive capacities, we must have a great expansion of business—roughly one-third more output and 7 to 10 million more jobs than we had in 1940.

I am not under any illusion that continuous full employment (i. e., a job always for every person who wants one) is possible in a private enterprise system. Some resources are always in process of shifting from less to more desirable employments. Some unused capacity is needed to prevent a wage-price spiral; and there are strong cumulative forces tending to produce economic fluctuations. But severe depressions and prolonged industrial stagnation, with their attendant mass unemployment, constitute the one great threat to the system of private enterprise. The average level of unemployment must be much lower than it was before the war if our freedom of individual choice and action in economic matters is to be preserved.

Whether or not there will be a rapid conversion and an adequate expansion of output after the war will depend in part on the farsightedness, the courage, the ingenuity, and the hard work of business men. If business men plan boldly for expansion of peacetime production and if they carry out their plans boldly, their efforts will reinforce each other and may lift employment and production to satisfactory levels. To realize these possibilities is the goal of the Field Development Division of the Committee for Economic Development. Throughout the country in each important community a local Committee for Economic Development is being organized to activate business men to plan now for speedy conversion and maximum expansion after the war.

The responsibility for post-war expansion is not, however, a responsibility which business can or should carry alone. As long as our economy is fundamentally a system of free enterprise, it must be a system of opportunities and incentives rather than a system of compulsions. Whether the opportunities and incentives will be adequate to induce the necessary expansion

will depend not only on what businesses do, but also, and in large part, on the policies and actions of government agencies and labor unions. The responsibility for creating a healthy climate for business expansion must be borne, therefore, not only by business men, but also by labor leaders, farm leaders, political leaders, government officials, and ultimately by all of us as citizens, each according to the power he possesses.

The factors which determine the opportunities and incentives for business expansion—factors which lie mostly beyond the control of individual businesses—are the focus of attention of the Research Committee, the Research Advisory Board, and the Research Staff of the Committee for Economic Development. We are working diligently to make a real contribution to better understanding of these matters. (I want to make it clear, however, that in this paper I am speaking for myself and not for the Committee with which I am associated.)

Without any pretense at complete coverage let me indicate a few of the factors which will be important in determining the rate at which peacetime business activity and employment will expand after the war.

Physical conversion of plants will not be a serious bottleneck. Many plants can be converted immediately, others with minor changes, and even in such complicated situations as automobile manufacture, peacetime operations can be resumed in about six months if new models are not introduced. Inability to clear plants of government inventories and equipment could, however, interfere seriously with conversion. In the case of government-owned plants, there may be rather long delays in concluding the negotiations for purchase or lease unless plans are made and preliminary steps are taken before the war ends.

In general, there will be adequate liquid resources to finance the conversion of business. If the government should fail to provide for prompt payments in settlement of canceled war contracts, many companies would be seriously embarrassed. But the total liquid resources of business are almost certain to be unusually large and individuals will also be in position to invest heavily if they choose to do so. This does not mean that all enterprises—especially small ones—will be able to obtain the funds needed for conversion and expansion; some will fail because the markets for equity capital are inadequately

developed. Even so there is not likely to be much shortage of funds for enterprises with good post-war prospects.

The accumulation of deferred demands for durable goods by consumers and for replacement and maintenance of equipment by businesses will have risen to huge amounts by the end of the war. Moreover, most individuals and businesses will have the funds to buy with if they choose to use them. Whether they will do so will depend not only on the urgency of their needs, but also on their appraisal of prospects for the future.

In this connection it should be noted that the purchasing power of money and government securities will vary inversely with changes in the price level. If prices and wages rise substantially during the war these liquid resources will be correspondingly less potent in the post-war period.

It would be folly to pin our hopes for lasting prosperity on the stimulus of deferred demands. As a matter of fact, the larger these demands and the more fully they are satisfied, the more severe will be the deflationary pressures when the " catching-up " period is over.

I hope also that our fears and perplexities will not drive us into a repetition of our N.R.A. experience. In the transition period, business groups, labor unions and farm organizations should have full opportunity to express their views, but it would be dangerous to entrust our fate to coalition organizations composed of representatives of these special interests. Collective action by these groups would be almost certain to restrict the opportunities for expansion and employment, to exploit the unorganized public, and ultimately to injure even the businesses, workers and farmers included in them.

Economic freedom means free access to markets and free access to jobs; and free access means competition. Many business men are discovering that one of the foundations of free enterprise is the anti-trust laws (whatever they may think of some aspects of their administration). Labor is now going through a stage of empire building, in some ways reminiscent of a similar stage in business three quarters of a century ago. While there can be no question of the right of workers to bargain collectively in order to compensate for their weak positions as individuals, I wonder whether labor leaders, as well as

the public, may not soon be giving thoughtful consideration to the question whether the grant of unlimited monopoly powers to labor unions is in the interests of the common good and ultimately in the interests of the unions themselves.

Wartime rates of taxation, and especially the excess profits tax, will certainly inhibit the expansion of business, if continued after the war. When the tax system comes up for post-war revision, it will indeed be a boon to enterprise if it is simplified and if it is overhauled so that the double taxation of corporation profits is removed and the impact of taxation is made to fall on individuals rather than on businesses. In the last analysis, it should be remembered, taxes do not fall on businesses anyway, but on stockholders, employers and customers. All this can be accomplished without violating any of the accepted canons of taxation.

Finally, I want to call attention to the urgent need for the coördination of the fiscal and monetary powers of the government and the use of these powers to help maintain a high level of production and employment. In the last fifteen years we have seen the devastation wrought by the collapse of our deposit money and the over-activation of the economy caused by large injections of deposit money during the war. We need to ponder these lessons and also to learn more of the causes of business depression and stagnation before we can use our fiscal and monetary powers wisely and with full effectivenes. In the meantime the different agencies of the government can at least stop working at cross purposes and coördinate their efforts to curb inflationary and deflationary developments. This will be of particular importance in the first phases of transition from war to peace and again in the transition from a "catching-up" economy to one no longer stimulated by accumulations of deferred demand.

The pattern of transition from war to peace will be what we make it. If we act foolishly or if we are dominated by pressure groups seeking their short-run selfish interests, we shall have a bad time indeed, but if we solve our problems wisely we shall, despite some transitional pains, soon achieve a plane of living much higher than we have ever known. This achievement will depend partly on our coping skillfully with the special problems of demobilization and reconversion, but it will depend

mainly on more fundamental factors: on the provision of adequate incentives for enterprise, on the maintenance of free access to markets and jobs, on the subordination of pressure group interests to the common good, and on the coördination of fiscal, monetary and other powers to avoid either serious deflation or inflation. Winning the peace is likely to tax our resources of common sense, courage and self-discipline, at least as much as winning the war.

Remarks by the Chairman

Chairman Mitchell: Our third paper this afternoon is to be presented by Dr. William I. Myers, Dean of the New York State College of Agriculture at Cornell University, who is speaking on "Agricultural Production and Price Policy". Dean Myers!

AGRICULTURAL PRODUCTION AND PRICE POLICY

WILLIAM I. MYERS

Dean, New York State College of Agriculture, Cornell University

FOR more than twenty-five years prior to the present war, United States food production did not keep pace with population. In the five-year period (1935-1939) just before the present war, our per capita production of all food was six per cent lower than during the corresponding period just before World War I.

This downward trend in food production was obscured by declining food exports and by the long depression of the thirties. During that decade, per capita food production in the United States was lower than in any other period in the present century. In no single year during the thirties did per capita food production get up to the 1926-1930 level. The public was told we had enormous food surpluses, but the real trouble was inability of consumers to buy rather than over-production. We were struggling with a price problem, not a surplus food problem. When employment increased, consumption rose and the so-called food surpluses disappeared quickly.

The people of the United States constitute the world's best market. In ordinary times we eat what food we want and then export the remainder, if any. Hence, as per capita food production declined, food exports decreased, food imports rose and for sixteen years prior to the present war our annual food imports exceeded our food exports.

Another factor contributing to the present food problem is that the steps taken by the government to increase production were added to agricultural programs established during the thirties and designed to restrict production in a period of low prices and widespread unemployment. As a natural result, acreage restrictions were continued even after the need for full production became clear. Although modified, in 1943 these restrictive programs still limited directly or indirectly the acreage of the best adapted crops that could be grown in many regions, thus preventing farmers from freely organizing their

resources for maximum production of food. At long last, it has been announced that all acreage controls on food and feed crops will be eliminated in the 1944 food production program.

Our government has planned generously for the armed forces and for munitions, ships and planes but, because of the erroneous belief that we had great surpluses of food, it has taken an abundant food supply for granted. Its actions have apparently been based on the assumption that production of all foods could be expanded to meet any needs that might arise without careful consideration and planning for agriculture such as were given to other vital parts of the nation's war economy. In recent months a number of constructive steps have been taken to remove some of the handicaps to full production of food. A man of nationally recognized ability and experience was appointed as War Food Administrator. However, since he was given responsibility without adequate authority, resignation was the inevitable result.

Another man of proven ability and broad experience in agricultural affairs is now serving as War Food Administrator. Although the present incumbent has been made a member of the W.P.B. and O.W.M., he, too, is handicapped by lack of authority in much the same way as his predecessor. Under the present administrative setup the principal function of the War Food Administrator seems to be to accept public responsibility for decisions on food policy made by the Director of Economic Stabilization and the Director of War Mobilization. No realistic program of food management and utilization has yet been presented to the American people. We are continuing to extemporize our food program from week to week in blind disregard of the dangers involved in such action.

Aided by favorable weather, farm families have turned in a magnificent performance in food production in spite of much unfair criticism and innumerable handicaps, regulations and annoyances. They have increased the length of their already long working day to the physical limit. Agriculture, however, is a biological industry. Food production is determined by the life processes of plants and animals which cannot be hastened. A delay of a month in a plane or a tank program means a month lost. A delay of a month in a food program may mean a year lost. Total food production cannot be increased quickly

except by the chance of favorable weather; nor can violent shifts be made promptly in the production of different crops and animals required to meet war needs.

Prices and Food Production

The food problem of the United States is in part a problem of prices. There are many important considerations in the farm price question in wartime. The question to which most public attention has been given is "What prices will give reasonable equity between the incomes of farm people and of other groups?" The most important question in wartime, however, is "What prices are necessary to get the essential foods produced?"

The principal cause of public misunderstanding of the farm price situation is the failure to realize that the 1935-1939 prewar period is an unsound base from which to compute relative wartime increases in farm prices and in factory wages. During the thirties city consumers became accustomed to food prices that were too low to be maintained in any period of active business which would provide alternative jobs for farmers and farm workers. In spite of considerable unemployment, the hourly earnings of employed factory workers for the period 1935-1939 were the highest in history up to that time and 14 per cent above the level of 1929. In striking contrast, United States farm prices were still at depression levels and 27 per cent below 1929. This disparity between farm prices and factory wages was further widened by wage increases, longer work weeks with overtime pay, and other measures which increased the pay checks of factory workers during the early years of the war.

Congressional insistence on the use of the "parity" formula in fixing ceiling prices of farm products was an attempt to prevent the general freezing of farm prices at levels that would restrict food production. While "parity" was a useful guide to the general level of farm prices necessary to maintain production, it cannot safely be used in the establishment of fixed ceiling prices for individual products, since it is based on historical relationships, many of which have changed. The use of parity for the establishment of ceiling prices for individual

farm products is responsible for many of the maladjustments among these prices at the present time.

During World War I, the per capita net income of the United States farm population increased more rapidly than that of the nonfarm population. Following 1920 the incomes of farm people declined and remained unfavorable in all except three years of the twenty-year period from 1921 to 1940. In 1942 and 1943 the per capita net incomes of the farm population have again attained a favorable relation with nonfarm, as compared with 1910-1914, although the estimated per capita net incomes in 1943 are $496 for the farm and $1,216 for the nonfarm population.

Although in August 1943 index numbers of retail prices of food were 37 per cent above the low levels of 1935-1939, they have increased less than the average per capita income of all the people in the United States. At present retail prices, the cost of a standard food budget takes 16 per cent of the average per capita income, the lowest figure in the last thirty years for which data are available and substantially lower than the range of 24 to 31 per cent during World War I. Actual expenditures for food at July 1943 retail prices amounted to 20 per cent of average per capita incomes, this higher figure being due to the larger proportion of choice foods being purchased by war workers at the present time.

With average yields the present level of farm prices will result in farm incomes which, while well below the earnings of industrial war workers, are favorable in comparison with farm incomes during the past twenty years. From the standpoint of long-time farm welfare any further marked increase in the general level of United States farm prices not necessary to meet higher farm costs is undesirable because it would increase the danger of inflation of farm land values. Furthermore, the families who remain on farms will do their utmost in food production at any level of prices. The vital question is not the level of farm prices that farmers want; it is the level that should be established in the real interest of the nation in order to permit farmers to retain labor against industrial competition, to meet increasing costs, and to maintain maximum production permitted by weather.

What Prices Are Necessary to Get the Essential Foods Produced?

The first requirement of a wartime food program is to insure the production of the kinds and quantities of foods necessary to meet probable needs. The only effective way to shift agricultural production is to adjust prices of the foods concerned to bring about the changes desired.

In spite of this, our food price policy has been consistently subordinated to the general program of rigid price ceilings to keep down the cost of living and control inflation, ignoring the effect of many of these prices in restricting production of needed foods. Little consideration has been given to the necessity for higher prices to cover the higher unit costs of short crops. " Rollbacks " have been ordered in the prices of meat, butter, eggs and other scarce foods to reduce the cost of living to some arbitrary level, without regard to their effect in reducing production and increasing the shortage.

In addition to restricting production, our food price policy has increased the difficulties of making wise use of our food resources. With many more workers employed, higher wage rates and longer hours of work, total factory payrolls are more than three times the average of the pre-war period, 1935-1939. Since supplies of other consumer goods and services have decreased because of war, this increased buying power has caused a sharp rise in the civilian demand for meat and other choice foods. In 1942, civilians ate substantially less than in 1935-1939 of the cheaper foods such as potatoes and dry beans, and considerably more of the highly prized foods such as meat, poultry, eggs, milk and cream.

In time of peace such a change in diet would be highly desirable, but in wartime it increases the pressure on a limited agricultural output, because of the relatively large amount of land and labor required for the production of these concentrated foods. In this situation, efforts to prevent inflation primarily by the use of rigid price controls have tended to decrease production of many scarce foods, to increase their consumption and to induce evasion or black markets.

The greatest danger in the present food price policy is the inflexibility of ceiling prices of individual food products.

Serious maladjustments in the price structure have been frozen there by inept and inflexible administration. Under ordinary conditions farm prices of food fluctuate constantly to bring about adjustment between demand and supply. Frozen prices prevent this corrective action and result in steadily increasing maladjustments the longer they are maintained.

The most unfortunate example of these price policies is the present corn-hog price situation. Corn is the greatest agricultural raw material of American farms. It constitutes about 60 per cent of all grain concentrates used by all forms of livestock and at the same time is an essential industrial raw material.

For many months the price of hogs has made corn worth about $1.40 or more a bushel as feed for hogs. At the same time, there has been a ceiling price on corn sold in the open market at $1.07 per bushel at Chicago. The result has been a phenomenal rise in hog numbers and increasing difficulty for corn millers, dairymen and poultrymen in getting corn for their needs. Naturally, they cannot get corn at the ceiling price because the government guarantees the corn-belt farmer a higher return by feeding his corn to hogs and selling the hogs.

Although the index numbers of corn prices have been held down, the cost of feed to northeastern farmers has not. Largely as a result of having to substitute oats and barley at about $55 a ton for corn at $41 a ton, but not available, prices of dairy and poultry rations have risen about 30 per cent during the past year.

In ordinary times corn-hog price relationships change frequently in accordance with changing conditions of demand and supply. Present food price policies have already jeopardized the supply of fresh milk and eggs for cities, foods which are of critical importance in the maintenance of balanced diets. If government price-fixing is to be substituted for market prices in the guidance of farm production, it is imperative that changes in fixed prices be made promptly, when occasion requires, if disaster is to be avoided.

If we produce too little food or the wrong kind of food, no rationing system can increase the physical supply or change its composition. The first job is to be certain that we produce

the needed quantities of the right kinds of food. The next is to see that the people get it who need it.

Food Subsidies

The critical problem in food price policy is to provide prices that will insure the required production of essential foods. Failure to do this would endanger the successful prosecution of the war. The subsidy question is concerned primarily with the problem of who will pay these necessary prices for food.

Farmers, as well as farm organizations, are opposed to the general use of food subsidies. They do not like the arbitrary administrative controls that always accompany subsidy payments. Then, too, farmers feel that war workers are well able to pay the necessary price for food.

If subsidies are to be used, they should promote and not hinder the objectives of the war food program. From this standpoint, the logical place for subsidies would be to stimulate the consumption of economical and abundant foods, such as potatoes, bread, soybeans and dry beans by providing low prices, through subsidy if necessary. It would be difficult to avoid the use of some subsidies, as incidental to guaranteed support prices, to insure ample production of such foods. However, to use subsidies to reduce the prices of scarce foods like meat and butter, on which we must economize severely, serves only to make rationing more difficult.

Can Total Food Production Be Increased?

For seven consecutive years, 1937 to 1943, the aggregate yields per acre of United States crops have exceeded any year in history prior to this period. In 1942, the total production of all *food* crops was 24 per cent above the 1935-1939 average. The estimated total production of food crops in 1943 is about 9 per cent below 1942 but about the level of 1941.

While hybrid seed corn, improved production practices and conservation measures contributed to these highly favorable results, another major factor was extremely favorable weather throughout the United States.

In view of these extremely favorable yields in recent years, the nation will be fortunate if it can maintain crop production at the 1937-1943 level during the remainder of the present

emergency even though all possible assistance is given to farmers. In spite of the steps taken, we still have critical shortages of skilled farm labor, machinery, fertilizer and essential supplies.

The extremely rapid acceleration in livestock production (principally hogs and poultry) during the present war was made possible by a succession of phenomenal crops, and was stimulated by very favorable prices of livestock products relative to feed. The 1943 production of meat and other livestock products will be about 10 per cent larger than the record output of 1942 because much of it is produced on last year's crops. We are now living on our fat but the meat supply will decline when the livestock population is reduced to available feed supplies.

Although the present demand for meat and other livestock products is almost unlimited, the total production of these foods is determined by the total available feed supplies. The amount of each will depend on existing price relationships. The prices of hogs have been more favorable than those of dairy and other livestock products throughout the present war period. The importance of maintaining the production of fresh milk and eggs has been stressed again in the recommended food goals for 1944, but the inevitable result of present price policies, unless changed, will be a severe, and perhaps a drastic, reduction.

Under the stimulus of the government program, livestock production has outrun feed supplies. The facts have been clearly evident for months. However, livestock numbers (especially hogs in the corn belt) are continuing to expand in spite of inadequate total feed supplies, because ceiling prices on feeds, especially corn, have prevented feed prices from checking the expansion of livestock at a point where all the animals could be fed. The only steps taken to date in regard to this critical situation are an announcement that the floor price of hogs will be reduced from $13.75 to $12.50 per hundred pounds on October 1, 1944 and a request to reduce the weight of hogs marketed and the size of the 1944 spring pig crop. The liquidation will be about over before these remedies could take effect.

The number of grain-consuming animal units on January 1, 1944 will probably be about 10 per cent above last year and one-third above average, while the total supply of feed grains is about 9 per cent less than a year ago. Thus the available feed supply per animal is about 17 per cent less than last year. Large quantities of wheat have already been used for feed, but no effective action has yet been taken to check the expansion in hogs. The only possible way in which feed can be provided for present livestock numbers is to use up the world's last important reserves of human food, wheat. Reduced pig production, marketing hogs at lighter weights, reduced production of choice grain-fed beef, reduced production of broilers and other poultry for meat, and less intensive grain feeding of dairy cows, all will be necessary to meet this feed situation.

A continuation of present policies will force those producers who run out of feed first to sell out regardless of the need for their product. If prices are not to be allowed to keep livestock and feed in balance, it is imperative that a plan be developed for the orderly liquidation of livestock numbers and the equitable distribution of available feed supplies, so as to provide feed for dairy cows and hens. The longer these readjustments are postponed, the more violent and wasteful the resulting liquidation will be, and the greater the danger of a serious reduction in the supply of milk and eggs for cities.

Feeding the People of Europe

During World War I our food exports increased from 6 or 8 per cent of production in the pre-war years to 17 per cent in 1919. About half of this increase in exports came from greater production while the other half came from reduced civilian consumption, made possible by changes in eating habits. With thirty-three million more people to feed here at home, our food exports varied between 2 and 5 per cent of our production in the years just prior to the present war. In 1943 our lend-lease shipments of food are estimated to be only 10 per cent of production, while our per capita food output is 25 per cent above the pre-war level. In this war we have increased production tremendously, but with high wages and ceiling prices we have raised our standard of living and have eaten up most of the increase ourselves.

* * * * *

For all practical purposes United States peacetime food consumption has about equaled production with the exception of wheat.

Because of the probability of less favorable weather and the shortage of skilled farm labor, machinery, fertilizer and supplies, the chances of increasing total crop production above 1942 are extremely remote.

At the same time, the United States is faced with imperative demands for more food. The needs of our allies are growing steadily. Every country released from Axis domination will bring further increases in demand. Sicily and Italy are only the beginning. These requirements are certain to increase during the remainder of the war and will probably reach a maximum after fighting ends in Europe. At that time, most of the hundreds of millions of people who have been under Axis control will need some food, until their own production can be restored, and much of it must come from United States farms.

In view of this situation, it seems clear that the answer to the present food problem must be sought in the better utilization of our present food resources. The only way to save much food is to increase the direct human consumption of potatoes, bread, soybeans, dried beans and other crop products and reduce the civilian consumption of meat and animal products. These crops are of first importance in wartime because they provide many times as much energy and critical nutrients per acre or per man hour as meat or livestock products.

Substituting direct consumption of crops for indirect consumption in the form of meat greatly increases the number of persons who can be maintained on a given quantity of crops. Animals are not efficient converters of grains and other concentrated feeds into human food although products richer in certain critical nutrients may result. In converting into livestock products the grain produced on United States farms in 1942 about 86 per cent of their energy value was lost without considering the hay, roughage and pasturage used as supplementary feed.

Any thought of feeding many additional millions of people on the diet to which we have been accustomed is utter nonsense. The 10 per cent of our annual production to be used for lend-

lease in 1943 would feed about thirteen or fourteen million people on a diet like our own. The same amount of concentrated foods would supplement the diets of a somewhat larger number of people. All told, however, the United States produced enough crops last year so that if all had been fed directly to human beings, they would have provided the energy requirements for a population more than three times our own.

If many additional millions are to be fed during the present emergency, it must be largely on wheat, soybeans, dried beans and peas, corn and other crop products. Although such a ration is not as palatable or as adequate nutritionally as one containing more livestock products, it will prevent starvation and provide a maintenance diet until European food production can be reëstablished.

A drastic decrease in our civilian consumption of livestock products is neither practicable nor necessary and only the direction of the change called for is suggested. The question of how far we can go without serious injury to health and morale is a question for the nutritionists to answer. The question of how far we are willing to go is a question for the people of the United States to answer. If we do not go quite a way, however, we shall not feed many people in addition to ourselves.

Remarks by the Chairman

Chairman Mitchell: The fourth and concluding paper upon the formal program this afternoon is that on "Post-War Control of Industrial Production and Prices", and will be presented by Mr. John W. Scoville of the Chrysler Corporation. Mr. Scoville!

POST-WAR CONTROL OF INDUSTRIAL PRODUCTION AND PRICES

JOHN W. SCOVILLE
Chrysler Corporation

BEFORE discussing the control of industrial prices and production after the war, it will be well to review these controls during the war.

The winning of the war is of such supreme importance that the federal government is given almost unlimited power to secure war weapons and men to fight with the weapons. The war soon reveals that there are not enough materials, factories, machines and men to satisfy both military and civilian needs. The government then progressively extends its control over materials and production so that more urgent military needs will have priority over less urgent military needs and so that all military requirements will have priority over civilian requirements.

The government controls production by contracting with private firms, by building government-owned facilities, by building up stock piles of scarce materials, by forbidding the manufacture of certain goods for civilian use, by forbidding transactions in certain materials without a government permit, by limiting civilian consumption by rationing, by allocating materials, and in other ways. It is unthinkable that we could wage war successfully without giving the government power to increase production and to produce those things most urgently needed to win the war.

While government exercises many controls through voluntary agreements, all parties realize that under the velvet glove of contract is the iron fist of compulsion. Since war is a physical phenomenon and is carried on by hurling physical objects at the persons or facilities of the enemy, it is generally recognized that in war the control of materials by the government is desirable and necessary. Of course, all control of materials is really a control of persons—the persons who own the mines, factories, machines and farms and the persons who work in the

mines and factories and on the farms. The third category of persons under government control is the fighting force. Government control over the persons in the combat forces is absolute; its control over the persons who own the facilities of production is nearly absolute; but its control over the persons who work in the mines and factories has been weak and vacillating.

While the combat forces and the owners of facilities are commanded, the industrial workers have been free to desert their posts and have been stimulated to increase their output by the opportunity to make a profit out of the war. Thus workers in manufacturing, after allowing for the greater cost of living, have increased their annual earnings over pre-war years by over eight billion dollars. This increase is more than twice as great as the total dividends paid by all United States corporations this year.

The statement that no one will be allowed to make a profit out of the war is obviously incorrect. While the control of production is imperative, control of prices during the war is not dictated by military necessity. In waging war, the rôle of finance is decidedly secondary. Wars are won with physical weapons—not with dollars, bonds, or prices. It is not true that a rise in prices would increase the real cost of waging the war. The real cost is the sum of the physical exertions of the people, the deaths and wounds and suffering, and the destruction of physical things produced by labor in the past.

There is a widespread delusion that war increases wealth, and many ask why we cannot be as prosperous in peace as in war. War is destruction, and the purpose of price controls, besides giving direction to production, is to distribute the losses among the citizens in a manner different from what the distribution would be without price controls. It seems necessary to maintain popular enthusiasm for the war to make people believe the war will not cost them anything, or that they can make a profit out of it. The government prints pieces of paper which it gives the people who make the weapons to be destroyed. These pieces of paper are issued in enormous quantities, but there is no corresponding increase in physical goods which could be used to redeem the paper. If the people were sufficiently intelligent and patriotic, they would retain only enough income to buy the civilian goods available, and would

pay the remaining income in taxes and put the war on a pay-as-you-go basis.

The printing of paper promises to pay dollars enables the government to postpone the decision, which is so politically disagreeable, as to how much of the war burden each citizen must bear. There is probably some hope, among socialistic politicians, that the war bond technique which distributes the taxes for the redemption of the bonds over many years can be used to saddle the bulk of the war costs on the upper income groups. This excessive printing of paper money is a monetary disease known as inflation.

Price controls are instituted to perpetuate a price structure which is no longer in harmony with the demand and supply situation, and rationing of civilian goods is used, not so much to offset the scarcity of goods as to counteract the plethora of money.

Fear of inflation is a skeleton in the closet whose bones are rattled by the opponents or proponents of every conceivable measure. Price control in wartime does not rest on as solid a foundation as production control.

In war, the control of prices and production by the government is for the purpose of attaining a definite objective—which is to win the war as quickly as possible and with the lowest cost in lives, materials and labor. Even with this single and definite objective, many decisions must be made between alternative methods. Should more steel be diverted from tanks to ships? Should more factories be built, or should the materials and labor be used in building weapons in existing factories? Should more farmers be inducted into the army, or is it more important to leave them on the farms to raise more food?

Since in war, manpower, materials and equipment are always scarce in relation to needs, millions of decisions must be made between alternative procedures. In war, it is necessary to decide which parts of our economy shall be controlled and which parts shall be free. As the war progresses, the controlled area expands and the free area shrinks. In the free area, there is a conflict, even among patriotic citizens, between the interests of the individuals and the state. Even in war, most workers desire higher wages, most stockholders would like higher divi-

dends, and most politicians prefer to make decisions which will enable them to retain office and power.

The wartime controls are irksome, but are accepted as the lesser of evils. We abandon liberty of individual action in the present, so that we can be free in the future. The justification of each wartime control is that it will help win the war. Of those who advocate a continuance of price and production controls after the war, I ask, for what purpose? What objective does the government then seek to reach? When the war ends, the single objective of winning the war will be replaced by millions of objectives which are the various desires and aspirations of millions of free citizens. When the war ends, there will be no single thread on which to string the beads of government controls. If the war controls are continued when peace comes, it will be necessary for government to make two kinds of decisions—it must then decide what objectives are to be reached, as well as what methods are to be used to attain them.

In war the controls are workable, for the people are united by a common danger and a common objective; after the war, this unity disintegrates into the conflicting and divergent aims of different groups, classes and sections. On what theory of government can we justify the continuance of wartime controls when we are not at war? What are the peacetime functions and purposes of government?

I believe government has two functions—first, to preserve the liberties of the citizens, to preserve order, to prevent citizens from injuring each other and, secondly, to do certain things which can be done more efficiently by collective action, such as coining money, regulating foreign trade, providing for the poor, etc.

This type of organization may be called a free society.

But some people believe that governments have a third function—economic control. If the economic control is extensive, we have a socialistic, communistic or totalitarian state. In spite of my congenital opposition to governmental controls, I admit that when the war ends, the government will have certain responsibilities. War brings about a cataclysmic dislocation of our economic activities and we must look to government to repair some of the damage caused by government. The surgeon who amputates a limb has a responsibility to see to it

that the stump heals properly. But when the war ends, the governmental controls should be general rather than minute and detailed.

There is a danger that when the war ends there will be a great rush to buy automobiles and other durable goods. We may get a great boom lasting for two or three years which may be followed by a great depression. The deficiencies should not be made up in two or three years but the building up of consumer inventories should be extended over a longer period. Competitive business is unable alone to effect a stable recovery. Government can damp down the boom by maintaining high income taxes, by selective excise taxes, and by allowing the prices of scarce goods to rise freely. It is too late to cure the depression after it arrives.

Depressions must be prevented by curbing the antecedent booms. The controls I advocate are general and do not destroy competition. An automobile boom can be moderated without requiring a person who wants to buy a car to go to a ration board to secure a certificate of necessity or to surrender his used car at a fixed price and without having a bureaucrat set a quota for the industry and for each producer.

Since any tax necessarily changes the pattern of production, I assume that it is proper for government to adopt a tax policy which will promote stability rather than booms and depressions. I make these concessions to the economic planners grudgingly, and I warn them that I will not travel very far with them. In 1933, Congress passed a number of socialistic laws, as emergency measures. The emergency never ended, and most of this emergency legislation is still on the law books. Then when the war came, more socialistic laws were passed to cope with the second emergency, which was the war. When the war ends, the transition from war to peace will be the third emergency, and this will be used as justification for the continuance or even enlargement of controls by the government.

Like Eliza crossing the ice, we jump from emergency to emergency; but, unlike Eliza, we are fleeing from freedom toward slavery—the slavery of the totalitarian state.

At the close of the war, we must decide either to continue the trend toward totalitarianism which began in earnest with the Great Depression and which was enormously accelerated

by the Great War, or to reverse our steps, throw off the governmental shackles, and again establish constitutional government and a free society.

When the war ends, we will stand at the crossroads of destiny —we must make the Great Decision.

In my own mind, our duty is clear. When the war ends, we should quickly remove the controls over prices and production, and endure any hardships this may bring, rather than procrastinate and flirt with the danger of permanent enslavement by a federal despotism. Will we do what we ought to do? Some say that the American people will be so annoyed, so irritated, so sickened with price ceilings, ration cards, ration points, ration boards, petty regulations and bureaucratic red tape, that there will be an irresistible demand for a speedy return to free markets, free prices and liberty. I hope this will happen. But I am sure that many powerful interests will seek to maintain the controls.

Let us consider some of the arguments that will be advanced for continuing the controls.

It will be said that if the controls are eliminated there will be a scramble for scarce goods, a rise in prices, and inflation. This, it will be claimed, will give the rich an advantage over the poor. If the prices of goods should rise, this rise will be the result of two factors—a scarcity of goods and a plethora of paper money. That part of the rise in prices owing to the scarcity of certain goods ought to take place. If butter is more scarce than oleomargarine, then the price of butter should rise relative to the price of oleo. That will divert consumption from the scarce article to the article that is more plentiful. If meat is scarce and wheat is plentiful, then the price of meat should rise relative to the price of bread. This will shift consumption from meat to cereals. If jobs are more abundant than workmen, then wages should rise, so that the limited supply of workmen can be used to satisfy the most urgent demands. If there are more workers than jobs, wages should fall so that all may be employed. If steel or lumber or tin is scarce, let sales be made to those who will pay the highest prices; presumably those who will pay the highest prices are most in need of the commodities. Uncontrolled prices perform useful functions—they increase the output of scarce goods, they

limit the consumption of scarce goods, they stimulate the consumption of goods that are abundant, they divert labor to the most necessary work, they operate to produce the greatest satisfaction of human wants. Those price increases arising from the scarcity of certain goods are not the effect of inflation, are temporary, are highly useful, and will vanish when the scarcity is overcome. With price ceilings the bureaucrats ration the people; with free prices, the people ration themselves, thus saving the administrative costs of rationing. When the war ends, prices should be adjusted to the demand and supply situation which prevails at that time, and not to a situation which existed in the past. Compared with ravaged Europe, our scarcities at the close of the war will not be serious—in many things we will have great surpluses. We will have our houses, factories, mines, machinery, coal, ships, farms, furniture, clothing, railroads, cars, locomotives. What scarcities we have will cause inconvenience rather than misery. Some say that if materials are not controlled after the war, a few big companies will buy up all available supplies. In my opinion, aluminum, copper, steel and other raw materials will not be scarce after the war. The plea for post-war material controls, based on material shortages, rests, I believe, on a false assumption.

Of course in a free society, the rich are always able to consume more than the poor. That is one of the advantages of a free society. It is also one of the advantages of being rich. Those who work more and produce more are then able to consume more.

Any plan to ration goods equally to all persons is pure and unadulterated communism. Equality brought about by rationing does not necessarily result in equity. It is not equitable to give every person the same rations on sugar and shoes; for some would prefer to go barefoot and eat more sugar, while others would be glad to dispense with sugar in order to have more shoes. Rationing does not necessarily result in greater equity or greater satisfaction than free markets and free prices.

I do not believe that the price rise which results from an excessive supply of money will or can be overcome by increasing the supply of goods. In the race between the manufacture of goods and the manufacture of money, I believe the printing press will win. This part of the price rise will not be elimi-

nated until the government collects and destroys vast quantities of paper money. If price controls to prevent price increases caused by the surplus of money are to continue after the war, then it may be many years before the government will have the courage to collect in taxes more money than it spends, in order to destroy the excess of money. Inflation, in my opinion, is an excessive supply of paper money, which causes a decline in the value of the dollar. Price ceilings are put on to rig the market for dollars and to maintain the value of the dollar at an artificial level above its true value. Congress, lacking the courage to collect necessary taxes, and adopting the motto " After Us the Deluge ", pays its bills by printing paper dollars. Then it tries to prevent and conceal the resulting decline in the value of the dollar by establishing price ceilings. Then to prevent the excessive consumption resulting from the excess of money and the low price ceilings, it resorts to ration cards and the allocation of materials. To effect these controls, the government then takes profits away from some groups and gives subsidies to other groups; controls production, distribution and consumption; makes millions of regulations; establishes boards and commissions; compels the citizens to travel from city to city to attend hearings, inquiries, investigations, and to spend innumerable hours waiting in long lines, buying on a day-to-day basis, fussing with ration cards and watching for dates of expiration—in short, our government becomes a totalitarian state.

If inflation is an excess of money, then price ceilings do not prevent the inflation, for you cannot prevent what has already happened. The price ceilings simply conceal and postpone the effects of the inflation.

If our paper dollars have a low value, the value of these dollars cannot be increased by keeping the people ignorant of the true situation. Forgive me for speaking of the value of irredeemable paper money. In my opinion such money is a phantom, a ghost, an illusion—it is such stuff as dreams are made of. Our dollars are disembodied spirits wandering in the limbo of monetary befuddlement.

When the war ends, let us rip off the camouflage of price controls and move out of the dream world of fantasies into the world of reality. If our paper money has had most of the value

squeezed out of it, let us know the facts. You cannot cure scarlet fever by covering up the red rash with white powder. If you say that a rise in prices would hurt creditors and benefit debtors, I reply, the damage has already been done. The question is whether the creditors should be informed in regard to their wounds.

In refusing to levy adequate taxes at a time when consumer incomes are high and civilian goods are scarce, Congress of course reflects the stupidity of those citizens who still believe that they can wage this colossal war without paying for it and without heavy sacrifices. The cure for inflation is the application of tax surgery to the swollen incomes and it cannot be cured by price control poultices and material control ointment.

Many of the controls instituted by O.P.A. were unnecessary and impeded the war effort. For example, there was no adequate reason for regulating the prices or distribution of either new or used cars. The supply of cars was fixed, and free markets would have allowed the cars to move to the persons and areas of most urgent demand. Rent control, in my opinion, aggravated the housing shortage. I doubt if the war effort was promoted by a ruling which compelled a merchant who gave away matches with cigarettes to continue giving away matches.

The argument that prices must be held down to prevent a rise in wage rates is an admission that labor unions are more powerful than the government or that the present administration is willing to exempt what is called labor from wartime sacrifice in exchange for political support. In war, no group should be free to exploit its strategic position.

I realize that governmental controls must be enormously expanded in war. What I am pleading for is a prompt elimination of the controlling agencies and a voidance of their ruling when the war ends.

When the war ends, what will be the function of the War Production Board? Will it seek to allocate steel to civilian industries? If so, what principles will it use to determine how much steel shall be allocated to the railroads, to the construction industry, to the automobile industry, and to other industries? And after determining the amount of steel allocated to the automotive industry, how will it determine the amount to

be allocated to each producer? How will it determine the steel allocated to a newcomer, like Mr. Kaiser?

For the life of me, I cannot even imagine any principles on which these allocations could be made. Of course the intuition of the leader may make principles unnecessary if we assume the authoritarian viewpoint, that superior minds have been given supreme power to determine what goods shall be made, who shall make them, who shall consume them, and at what prices they shall be sold.

The difficulty of post-war controls arises from our inability to define governmental functions in terms of economic objectives. Since there seem to be no rational reasons for economic controls by the government, an attempt is made to discover ersatz reasons.

Some say the purpose of government is to secure the *maximum use of resources.* Such a statement is unintelligible—at least to me. How much coal must be mined, how many trees must be chopped down, how much wheat must be raised, how many barrels of oil must be pumped out, how much must be produced by each industry, how many hours must each factory operate, to secure the *maximum use of resources?* Of course no one knows. This is simply a catch phrase, a bubble of gas welling up from the deep pools of intellectual confusion.

Another catch phrase that is going the rounds now is that it is the responsibility of business, society, or government to produce *full employment.* This phrase is just a political slogan. No one is able to define full employment. Furthermore, people do not want labor, work or employment. They want goods and services. As technology advances, we get more goods with less labor. If a person works for himself, he gets employment by rendering a service or producing something that others want and offering it at a price that others will pay. If he wants to work for someone else he must convince an employer that his competence, industry and wages demanded are such that it will be profitable for the employer to hire him. If the government wanted to encourage production and employment, it would leave the citizens free to enter into mutually satisfactory agreements, and it would allow those who demanded more than others would give to suffer until they were compelled by economic pressure to reduce their demands. In-

stead, the government passes laws to shorten hours of labor, raise wages, reduce profits, fix retail prices, limit agricultural output, and promote labor unions, all of which things reduce output and employment, and also passes laws to relieve job seekers from economic pressure, which further reduces employment. I deny that it is the function of the federal government to provide for the welfare of favored groups of citizens. It is the function of government to maintain order, to protect property, and to preserve the liberties of the people, so that each citizen shall have the opportunity to provide for his own wants according to his capacities, ambitions and desires. No one can give us full employment or happiness; the general welfare is a by-product which comes to us when the citizens are free, when the people are virtuous, when the laws are just, and when the powers of government are strictly limited.

The best way to get an adequate supply of goods and services, which is perhaps what is meant by full employment, is to remove, at the end of the war, not only the wartime controls, but many of the controls that were inaugurated before the war. I believe that when the war ends, we should take the following steps:

1. The government should quickly terminate contracts for military goods and should make prompt settlements with contractors.
2. The government should decide which government-owned plants and what raw materials, supplies, equipment, etc., should be retained by the government, for purposes of national defense. Some of these plants would be operated as government arsenals, and others would be greased and guarded as stand-by facilities.
3. All other plants, materials, supplies and equipment should be sold to the highest bidder under the following conditions:
   (a) the properties should be extensively advertised;
   (b) the government should act as a wholesaler not as a retailer;
   (c) properties should be disposed of rapidly, but not so quickly as to cause unnecessary loss to the government;

(d) no bidders for government-owned property should be given preferential treatment;
(e) no government property should be destroyed, or held off the market, to promote the manufacture of similar goods;
(f) the government should promptly remove government-owned machines and supplies from privately owned plants;
(g) there should be a public record of all sales of government property.

4. No government-owned plants except arsenals should be operated by the government or by government corporations.
5. Congress should dissolve the O.P.A., the W.P.B., and the W.M.C. within sixty days after the end of hostilities.
6. All land, plants and buildings acquired by the government for war purposes and not needed for defense should be sold to the highest bidder within two years.

In short, when the war ends, we should get out of the war with dispatch. It is easy to state these procedures, but I realize that the execution of these tasks will be a colossal undertaking. The war will probably not end suddenly, but will taper off by successive stages. In the early stages of war production, vast inventories of ships, tanks, planes, ammunition, etc., are built up. Afterwards, the only production necessary will be the replacement of losses. At this stage, contracts will be reduced or canceled and war production will decline. With this kind of ending there should be a progressive elimination of controls.

If we slowly convert from war to peace, very knotty problems will arise. For example, if it is decided that a limited number of radios, refrigerators, or automobiles should be made, which company will be directed to make them? When steel becomes available for civilian goods, who will decide which goods will have priority? What will be the basis for these decisions? When the government commands certain firms to continue making weapons of war, it thereby prevents these companies from making civilian goods.

I see no way in which such decisions can be made without discrimination. War and justice are incompatible. Many business casualties and wounds result from war. I believe that

many industrialists will take the position that after the war the controls should be removed as soon as practicable; as soon as feasible; as soon as possible. This begs the question—and procrastination is dangerous. Many labor unions will object to the sale of government supplies and will favor price controls to keep down the cost of living. Bureaucrats and government clerks will hang on to their jobs with great ferocity. For patriotic reasons, they will not want to discontinue their valuable services in the control of our economy. It would indeed be ironical if our boys, who are fighting tyranny and totalitarianism abroad, should return home to find that we had embraced here the very thing they fought against. I believe it will require vigilance and determined efforts on the part of all lovers of freedom, to protect our liberties from being strangled by the federal octopus, which lures the citizens by promises of jobs, security, and protection from every hazard of life from the cradle to the grave, and only asks that in return for these gifts they give up nothing but liberty.

The Michigan poet, Will Carleton, wrote a poem called "The Doctor's Story". He described the sick room in these lines:

> Mrs. Rogers lay in her bed,
> Bandaged and blistered from foot to head.
>
> Blistered and bandaged from head to toe,
> Mrs. Rogers was very low.
>
> Bottle and saucer, spoon and cup,
> On the table stood bravely up;
>
> Physics of high and low degree;
> Calomel, catnip, boneset tea;
>
> Every thing a body could bear,
> Excepting light and water and air.

He then describes how the doctor swung into action:

> I opened the blinds; the day was bright,
> And God gave Mrs. Rogers some light.
>
> I opened the window; the day was fair,
> And God gave Mrs. Rogers some air.
>
> Bottles and blisters, powders and pills,
> Catnip, boneset, sirups, and squills;

Drugs and medicines, high and low,
I threw them as far as I could throw.

"What are you doing?" my patient cried;
"Frightening Death," I coolly replied.

"You are crazy!" a visitor said;
I flung a bottle at his head.

All the people have poohed and slurred,
All the neighbors have had their word;

'Twere better to perish, some of 'em say,
Than be cured in such an irregular way.

I hope that when the war ends we can imitate this doctor, open the window, throw out the O.P.A. pills and the C.M.P. bottles, and let in the fresh air of individualism and the sunlight of freedom. I realize that the practitioners of planned economy look on this kind of recovery as irregular. Nevertheless, if they will give the country back to us, I am sure we can achieve a quick and sound recovery.

Remarks by the Chairman

Chairman Mitchell: Ladies and gentlemen, in accordance with the traditions of the Academy, we will now spend not more than thirty minutes in informal discussion from the floor. Any members of the audience who wish to contribute to the discussion are urgently requested to come forward, give their name to our recorder, and face the audience so that they may be heard clearly. Comment is invited![1]

To those who have participated in this discussion and to our four speakers, I express the thanks of this audience and of the Academy; and I declare the meeting adjourned.

[1] Space limitations make it impossible to print in these Proceedings the interesting discussion by several members who spoke from the floor under the ten-minute rule.—Ed.

PART III

ROADS TO VICTORY

INTRODUCTION *

LEWIS W. DOUGLAS, *Presiding*
President of The Academy of Political Science
Deputy Administrator, War Shipping Administration

MEMBERS of the Academy, Its Friends and Guests: A year ago tonight, there presided over the dinner that was then held, with a skill and a charm unsurpassed, a person who occupied a distinguished position in his community, in his state and in his nation, a person recognized for his talents in the academic world and acknowledged in the business community, a friend and a scholar, who no longer can preside, as he often did, over occasions of this character, one whom, because of his generous friendship, which he extended widespread, we shall all miss, one whose absence we all regret. I speak of Dr. Frederick Keppel.

The day's proceedings have come to a close. In the name of the Academy, I should like to extend its thanks and its appreciation to those who have contributed to the discussions, added to our knowledge and to our wisdom.

Wherever we may have been at the time, no one of us can ever forget twenty-five years ago almost to the exact hour when silence fell upon the western front. But some of us may not recall that during the first World War, when General Tasker Bliss was asked how long it would last, he replied, "Thirty years." An old prophecy was confirmed by the forecast of the Prime Minister of Great Britain yesterday.

During the last twenty-nine years, we have all been engaged in international conflicts. At first, they took the form of mere

* Opening remarks at the Third Session of the Annual Meeting.

economic differences, then they moved on into the orbit of political controversy, and finally appeared in isolated manifestations of resort to arms, ending in a widespread, world-wide conflagration.

During the last four years, the sweep of armies and of armadas across continents, touching the shores of every land, has been the preoccupation of us all. Those darkest days and darkest hours of 1940 and 1941, yes, even of 1942, have at last been penetrated by rays of light that disclose the road, however smooth or however rough, however long or however short, that leads with assurance and with certainty to ultimate victory.

Back of the valor and the courage of our Russian allies, of Stalingrad and of the salvation for us that they produced, back of what must seem to them the interminable struggle in which the Chinese have been engaged against the marauder of the Orient, back of the defense of Cairo, back of Montgomery's chase across North Africa, racing after Rommel, and of the landing in North Africa and of the extermination of the German army there—back of these events and these acts of arms and men that since 1940 have slowly but relentlessly turned the tide of war with certainty in our direction, back of all these things there is the performance of the Royal Air Force in 1940. [Applause]

Writing a chronicle of bravery unsurpassed in the annals of warfare—supported by a determined people, reinforced by a resolute and articulate Prime Minister of England—this gallant body of young men, high in the skies over the waters of the Channel and the countryside of England, met the enemy and defeated him. And thus, they gave to us a chance to fight for our free existence.

In 1925, Dwight Morrow presented his official report on the development of aviation. He wrote, among other things, "wars may start in the air but they will always end in the mud." It is not necessary now to debate that point. The human mind, which formerly had been accommodated, through centuries of experience, to warfare in two dimensions, has at last begun to realize that it can be waged in a devastating manner within the limits of the third. And if there are some who believe—many who believe—that an air force by itself, operating on its own, cannot bring the enemy to his knees, no

one can now deny that an implement of warfare that can stretch out over seas and mountains, plains and rivers, and destroy a thousand miles from its base a vital and necessary part of the enemy's defense, is not on its own an element of warfare that must be and will be hereafter recognized as an essential to victory. [Applause]

In accordance with the recommendations of that report, there was established in the Navy and in the Army, the positions of Assistant Secretary of War, and of the Navy, for Aviation. F. Trubee Davison was the first person to fill that position in the War Department. Under him, in the Army Air Force, there was a nucleus of young men. They were brave and they were talented young men. One of the speakers of this evening was a member of that group, decorated in the last war for heroism, an ace indeed of the American air force, distinguished in this war, recognized by his own government and by foreign governments, Commanding General of the Eighth Air Force Fighter Command, based on England during those tough and early days, and now in command of the First Army Air Force, Brigadier General Frank O'Driscoll Hunter.

I knew him in the old days and I am happy to be able to renew that association and acquaintance on this platform. I am particularly happy to introduce him to you in order that he may address you on the subject of "Roads to Victory". General Hunter!

[The audience arose and applauded.]

Remarks by General Hunter

General Hunter: I know that you will be disappointed that General Arnold has found it impossible to be here tonight as scheduled. He has asked me to express his sincerest regrets, and to substitute for him. As you can readily understand, since he is Chief of the Army Air Forces, unexpected important official duties frequently interfere with previous plans.

ROADS TO VICTORY

BRIGADIER GENERAL FRANK O'D. HUNTER *
Commanding General, First Army Air Forces Headquarters
Mitchel Field

WITHIN less than a month we will be completing the second year of war and embarking on the third. Therefore, it is a proper time to take stock of where we stand.

It is the democratic privilege of the American people to receive truthful, periodic reports on the war's progress that withhold only such information as might be of aid to the enemy. Such reports are a source of strength—from town hall to large metropolitan newspapers—and they mark the fundamental difference between a free and an enslaved people.

Now, let us review our own position—particularly in the air.

While the nation was plunged into this conflict on December 7, 1941, the Army Air Forces had been struggling ever since that August day in 1909 when the Chief Signal Officer of the United States Army purchased one Wright Brothers' airplane. From that moment, a few farsighted men endeavored to create an air arm that could repel attack by any possible combination of enemies. Without that faithful labor, the sudden expansion of the Army Air Forces that took place before and after Pearl Harbor would have been impossible.

You cannot build a skyscraper without a foundation.

The sneak attacks on the Hawaiians and the Philippines were sudden, vicious and successful. There seemed, to Germany and Japan, little to stem the tide of their aggression. The enemy began to study maps of South America and talked of dictating peace in the White House. It was inconceivable to them that we could accomplish in a matter of months what had taken them years to do.

The enemy either did not realize or they ignored several things. Where our air power was concerned, there were three principal facts of which they were ignorant.

* On November 30, 1943 the Senate confirmed General Hunter's promotion to the rank of Major General.—ED.

(1) While our Air Force was small, the basis laid by the early aviators, engineers and technicians was solid. The old Army Air Corps had drawn up the blueprints; the limited budgets had been used wisely for such experimental aircraft as the Flying Fortress, the Liberator, the Thunderbolt, and the Lightning, and they had enabled our manufacturers to expand their facilities for real production.

We did not have the planes but we had the plans.

(2) Our strategic concept of air power was sound. In our expansion and operations we did not intend to repeat the mistakes of the Luftwaffe.

Our air concept included both tactical and strategic operations with the heavy bomber as the principal weapon. It envisioned long-range operations in daylight, directed at pinpoint targets from high altitudes. We developed a bomb sight capable of such accuracy, and aircraft to reach and bombs to destroy those targets.

(3) Behind it all was a nation that was free, resourceful and the most highly industrialized in the world. The fascist countries put rifles in the hands of the children—while our youth tinkered with pliers and wrenches.

These three fundamental facts account for some of the amazing statistics of our growth. To take a random example, in May 1941, the Air Transport Command was composed of exactly *two* officers and *one* clerk. Today, it has over 57,000 officers and enlisted men and operates throughout the world.

The expansion of the Army Air Forces was not merely a problem of producing more—and still more. That would have been a relatively simple matter for a country such as ours. In addition to the problem of quantity, there also had to be met the problem of quality and of changing types of aircraft brought about by the needs and lessons of the military fronts.

For example, combat experience showed recently that enemy aircraft preferred to attack the B-17 bomber in numbers from the front. Therefore, to meet these attacks, the chin turret was devised and production lines had to be changed accordingly. Now, all B-17's are coming off the line with this new turret.

The bald statistics cannot give a true picture of the modifications that accomplished our expansion. When I say that 68 per cent more airplanes were received by the Army Air Forces in the first quarter of 1943 than in the comparable quarter of 1942, it is an impressive figure but it does not give the whole story. However, when I say that, for the same period, the airframe weights of our aircraft increased by 140 per cent, you begin to get a better picture. It shows that not only have we increased the numbers of our aircraft but also that heavy, four-motored bombers shared in this increase to greater extent than the lighter craft.

The growth of the Army Air Forces has not been limited to any one of its specific branches but is typical of the entire service. The second year of war has seen an increase in personnel over the first year by one million. Our yearly production rate of pilots is now over 75,000.

So it goes—and naturally the question arises as to what has been done. Our accomplishments are a thrilling and an almost unbroken record of successes against—at the start—almost impossible odds. One hundred and seventy-seven airplanes and 123 Jap ships smashed at Rabaul; 22 surface ships sunk in the Bismarck Sea battle; vital industries at Schweinfurt, Regensburg, Munich destroyed by precision bombing; German fighters—now on the defense—shot down by the hundreds; targets in Burma, Wewak or the Kuriles destroyed. Major operations such as these have become so commonplace that the newspaper reader expects such a daily headline as a matter of course.

Our air map of the European front is an excellent measure of our progress. Last year, our Eighth Air Force celebrated Independence Day by its first bombing of the European mainland. It was an attack on an airdrome in Holland by a handful of airplanes. Later these attacks spread to the Ruhr, then to central Germany, and now they have reached Danzig and Poland. No longer a handful of airplanes but now by ever increasing hundreds, these attacks are carried all the way across Europe from England to Italy.

Currently, the Eighth Air Force is engaged in the daylight, precision bombing of Germany and German-occupied Europe. Its objective is to make the invasion of "Fortress Germany" as economical as possible and to reduce Germany's ability to

conduct large-scale warfare. It is a long-range plan that is complemented by and coördinated with the British system of night saturation bombing. Through it, we are seeing the progressive destruction and dislocation of the German military, industrial and economic systems. By the thorough destruction of German cities—leaving some one and a half million people homeless—we are undermining the morale of the German people to a point where their armed resistance is fatally weakened.

Germany realizes full well the danger of this plan to her. She is doing everything possible to stop our bombers, as evidenced by the fact that 75 per cent of all her fighter production and pilot output is allocated to this air front.

Emden, Schweinfurt, Hamburg, Regensburg — remember them and all the others; for hundreds, yes, and maybe thousands, of American lives have been saved at those places. True, lives were lost in the process but that is the inevitable cost of great accomplishment in war. When we stack the gains against the losses we realize that air warfare is extremely economical in men and matériel.

The damage done to the Ploesti refineries not only reduced Germany's output of oil but also forced her to supply her eastern front from more distant refineries. Therefore, an added load was put on her already overburdened transportation facilities. That is just one example of the dislocation—both economic and military—caused by these bombings.

Each of these bombing missions requires careful detailed planning—for each one is a major battle. You will notice that I do not call them " raids ". The relatively few men that comprise the attacking force compared to the damage inflicted demonstrate air power's great virtue—its economy. However, the defense against our attacks comprises a major force. It has been estimated that Germany must employ one million men for her antiaircraft guns alone and another two million for related tasks. Were it not for our operations, this gigantic manpower would be utilized in the factories and on the battlefields.

The fortresses that daily cross the Channel are building a bridge for the invasion of Europe. They have opened a battlefront 20,000 feet above the heads of the German people — through the roof—the only route at present open into the heart of Germany itself.

The second theater to be considered is the North African. The past year has seen the complete defeat of the enemy in Africa. The systematic devastation of the enemy's lines of communication that preceded the attack, and the complete air domination that accompanied the final defeat, prevented evacuation from the Cape Bon Peninsula. This is a perfect example of ground and air coöperation.

Then followed the historic fall of Pantelleria, a laboratory demonstration of the power of bombs. Then the landings on Sicily, and finally on the Italian mainland.

These successful operations were made possible by air power. Our bombers blasted enemy ground forces before, during and after the landings. Our fighters protected our own troops from hostile air attack. Air power was indispensable at the critical stages of those important invasions.

Today, the sea lanes are covered from air bases in southern Italy, and the enemy has, to all practical purposes, been forced to abandon his air defense of this area. Our new airdromes serve as bases both for tactical operations and for the strategic bombing of previously inaccessible parts of Europe.

There is no place left in central Europe for the enemy to hide. He is like a goldfish in a glass bowl. He cannot escape from the relentless destruction of our bombers. We range from his submarine bases on the Atlantic, to the airplane plants at Danzig, to the Rumanian oil refineries at Ploesti on the Danube.

In the Southwest Pacific, it has been a war principally for airdromes. The efforts of all our Armed Forces have been directed toward securing strategic locations for air bases. Now, we are nearing positions where we can get at some good red meat like Rabaul—and it will not be rationed.

The record of our Fourteenth Air Force in China is highly satisfactory. The men over there operate under great handicaps, for their supplies and personnel have to be flown into China, with a part of the trip over enemy territory. Get this straight—every drop of gasoline, every round of ammunition, every bomb must be flown into China. Often the same crews and airplanes that go on a combat mission must ferry in their own supplies. When we remember those things, then the record of shooting down nine enemy planes for every one lost becomes amazing.

There, in its broader sense, is the picture of our air war during the past year. To the personnel—pilots, navigators, bombardiers, gunners, ground crew—to all of them should go the credit. It is difficult to describe exactly the qualities that make the men of our Air Force what they are. It might be a combination of intelligence, a sense of humor and pride, loyalty, the will to do the impossible—a thousand other things—but whatever it is, they have it. They use their brains and ingenuity in a manner that is typically American.

When matériel is not available they invent contraptions to make repairs, move heavy machinery or build runways. I have seen some of these gadgets and knew they could not work—but they did. There was a case in the Southwest Pacific where the available transport planes were too small to carry a two and a half ton truck that was needed. But that did not stop the ground crew. They got acetylene torches and simply sliced this truck in half. Then the two parts were flown to the front where they were welded together again and the truck rolled away as good as new.

There is no limit to the ingenuity of such men. Lack of refrigeration in hot climates does not worry them. When going on high altitude missions they take up full canteens of warm water and return with it nicely iced.

Our personnel also has a sense of humor. It is a most important quality which can keep them going under the worst conditions. It is well demonstrated by a story of two Staff-Sergeants—the gunner and bombardier of a B-17. This gunner, it seems, had a fine wrist watch that the bombardier greatly desired to own—but it was no sale. The gunner was offered 40, 50, 60 dollars for the watch but he turned it down.

Then, one day, they went on a mission over Central Germany and ran into trouble on the way home. The fortress was hit by flak and it became a straggler. It was immediately set upon by about a dozen enemy fighters. A motor was knocked out, its aileron cable severed and a shell started a fire in their radio compartment. They were still three hundred miles from their home base and it did not look as if they would ever get there.

In a momentary lull, while enemy fighters were getting into position, there came the calm voice of the gunner over the interphone system, speaking to the bombardier: "Okay,

Freddie, you can have the watch for 60 bucks." Incidentally, they got back and the deal went through.

Our personnel also has a feeling of pride. You can see it in the way they talk and act and carry themselves. It does not stem from any conviction that they are supermen, or Sons of Heaven, but from a firm knowledge that they are doing their share in our country's fight for survival.

The accomplishments of our Air Force during the past year naturally raise the question of what we will do next year — what are our future plans?

To answer it simply, we will continue on the road to Berlin and Tokyo. Our precision bombing will be expanded, for we have proved two facts to our satisfaction and the enemy's sorrow: first, that daylight bombing operations against selected precision targets from altitudes of 20,000 to 25,000 feet in the face of antiaircraft and fighter defenses is perfectly feasible; and second, that properly selected and fused bombs will destroy any known industrial structure.

Naturally, there will be losses, for it is impossible to conduct warfare without them. Our men, however, are not expendable: the losses will be kept at a minimum and they will be justified by the results. In the first World War, the calculation of justifiable effort as opposed to result was often based on how many tons of steel were required to kill one enemy soldier. We no longer calculate that way. Today, we want to know how many tons of bombs are required to put a certain factory, bridge or shipyard out of commission, and when it will be necessary to revisit it and bomb it again.

We expect Germany to come up with new tactics and possibly new weapons. War is a continual process of measure and countermeasure. Germany will try anything to prevent our bombers from coming over and demolishing her industries one by one. However, it is doubtful whether she will have much success along that line. We must outthink, outguess her. We also will have our share of new developments, and in a race of laboratories, our bets go on American brains and ingenuity in a land where we can work efficiently without the constant threat of bombing.

Finally, our plans envision still further expansion of the Army Air Forces. That is essential because we cannot afford

the luxury of underrating the foe. There is no such thing as a "second chance" in warfare. The enemy is strong and, what is more, he is desperate. Any lessening of our effort now would court disaster.

There is much to be done, because warfare is expensive. Since Pearl Harbor, the Army Air Forces have consumed some two billions of gallons of gasoline and expended well over forty million rounds of ammunition in combat. To supply that ammunition, gasoline, aircraft and all the other essentials is the job of the home front. We must give our men all the weapons they need and the best. If we do not, not only are we guilty of poor military strategy but we also risk a breakdown of their morale.

I can tell you about their morale in the toughest, hottest air theater of the war.

Over Germnay itself and over the Nazi-occupied countries of western Europe is where we are landing the most telling blows. That is where we are hitting Hitler's industrial solar plexus.

England is the corner from which our fighters and bombers spring to deliver those devastating punches. I have just returned from England and from command of the Eighth Fighter Command. The problems of pilots in combat—their joys and sorrows, their lives and deaths—are very vivid in my mind.

Each of their missions brings its losses. But they are taking those losses with a spirit that is high and unflinching. Their morale is splendid. They go up ready to take on as many of the enemy as come, knowing they are sapping the enemy's strength and believing that they are making it easier for invasion by our ground forces. In that belief, I think they are fully justified. In my opinion, for every life lost in the air now, hundreds will be saved on the ground later.

We have good reason to be tremendously proud of those young Americans. I was proud, indeed, to be associated with them, and all that they ask, for what they are giving, is that we continue to send them the planes and equipment and replacements they need.

It's our job to deliver—for theirs is the high-soaring courage of America itself. We must not let them down.

Remarks

Chairman Douglas: I think it was Barrie who said in *The Little White Bird* that the reason why birds can fly and men can't is that birds have faith. You, General Hunter, are symbolic of the faith that gives you and men of your calling the ability to soar on wings high up into the sky.

We are grateful to you, sir, for this recital of the progress of our pilgrimage in the air, and of this implied story of our performance, tip to tip, as it were, with the Royal Air Force, flying over the continent of Europe assaulting Hitler's stronghold, and of our actions over the South and Southwest Pacific.

Each one of us, I presume, establishes for himself, in anything he may undertake, a certain standard of performance by which he tries to measure his own action. About a hundred years ago in Ireland during a political campaign, a speaker, a prominent and principal speaker of an evening meeting, was introduced by the chairman of the occasion. The chairman took considerable time—according to his own standards, not too much; according to the standards of others, far too much—to introduce the distinguished orator.

When at last he took the platform to deliver his address, he reminded his audience of that old Irish legend that ran something like this: Whenever a baby is born in Ireland, it is always kissed by the fairies. If it is kissed on its eyes, it is clear evidence that when the baby reaches maturity, it will be a great artist. If it should be kissed on its ears, it is known that it will be a great musician. If on its mouth, it will be a great public speaker. "Now," said the orator of the evening, "I cannot say precisely what part of the anatomy of the chairman was kissed by the fairies, but I can say that he's a darned good chairman!" [Laughter]

I have been very apprehensive about performing this task this evening because I felt quite confident that I would be unable to meet that high standard of performance.

There are two phases of our task. The first is to defeat the enemy. General Hunter has dealt with one of the most important and one of the most significant of the implements of war at our hand, with which we undertake to achieve that result with a certainty that cannot be controverted. The second phase of our problem is to preserve the fruits of victory to establish an enduring peace upon enduring foundations.

It was Lord Acton, I think, who said that if knowledge of the past was considered by some to be a hindrance and an interference, it must also be recognized as the source of our emancipation. The

past discloses in an undebatable fashion that political arrangements alone are not enough to preserve a peace. They are not enough to prevent resort to arms as the final court of appeals. The past discloses that these political arrangements must be integrated with other things that move human beings to action; that economic force must be molded into, welded into the structure of political arrangements.

The past suggests that no matter how perfect the political accommodations may be, commercial intercourse between nations must become unfettered, and that the handmaiden of this intercourse, an international currency of durability, must be established. And the past further suggests that we must avoid identifying the proprietary interests with the sovereignty of the state, lest what previously existed as a conflict between individuals, not having the power to resort to force, assume the character of a struggle between nation states.

These are some of the things that the past discloses and that, if recognized by us, may lead to our emancipation. But, fortunately, there is, as our distinguished guest tonight, one far better tutored in these things than I, one skilled by tradition and by training and by inheritance, the best of the best that England can produce, one of a long line of public servants dedicating their lives, as they have in the past and as he is in the present, to the welfare of his people and of the world.

Intimately associated with education, Fellow of All Souls College at Oxford, once Chancellor of that great University, he has occupied so many offices of high distinction in his own government that I would be violating the standard which I originally established if I were to undertake to recite them. Viceroy of India, Lord President of the Council, Secretary of State for War, Secretary of State for Foreign Affairs, and now British Ambassador to the Government of the United States, His Excellency Viscount Halifax!

[The audience arose and applauded.]

THE RIGHT HONORABLE VISCOUNT HALIFAX: Mr. President, Members of the Academy, Ladies and Gentlemen: I made the reflection while Mr. Douglas was speaking that the fairies had kissed him all over. [Laughter and applause.]

When he began that portion of his speech, I went through a few moments of anxiety lest he might be tempted to imitate the speech once made by a chairman of a great meeting, I think at Toronto. The purpose of that chairman was to introduce a soldier who had acted with great heroism and gallantry in the war and had been honored with the decoration of the Victoria Cross. But he was known to be a better soldier than orator, and, accordingly, the form of intro-

duction that the chairman thought would just put him right with the audience was to say, " Now, I have the great honor and pleasure of introducing—whatever his name was—who has been through hell for you, and it's up to you to go through hell for him!" [Laughter]

Your President was more indulgent, and I need not tell him that I was deeply touched by the kindly way in which he presented me to this great company. It is a privilege which I greatly appreciate, that of being here tonight in this company that is concerned, as by title and purpose you are bound to be, with many studies which can never have been of more vital import to the world than they are today.

The proceedings in your current sessions are devoted, naturally, and indeed, I should suppose, inevitably, to some of the issues presented by this phenomenon of total war. For me it has been both valuable and pleasurable to listen to speeches both from President Douglas and from General Hunter, who, in their different spheres, are making, if they will allow me to say so, such daily and such notable contributions to our common victory. [Applause]

General Hunter, with the special knowledge and the special authority which he can command, has spoken of the war itself and has spoken, as he rightly may, with pride of the service in which he has the honor to serve. I also had the honor and the pleasure of seeing something of the Eighth Air Force Fighter Command when I was in England the other day.

The President has forcefully reminded us of some of the other deeper currents of thought that are running in these years. It is certainly true, as he said, that we can never hope to understand any political situation unless we know something of the history by which it has been created. He spoke of Lord Acton. I think that Edmund Burke said that people will not look forward to posterity who never look backward to their ancestors, and in that, I venture to think, he was expressing a very profound truth.

Therefore in the few minutes that I have tonight, if I may interpret the subject somewhat freely, I would like to go back over some pages of the past that seem to me to have a bearing upon the situation in which both you of the United States and we of the British Commonwealth today find ourselves.

ROADS TO VICTORY

THE RIGHT HONOURABLE VISCOUNT HALIFAX
British Ambassador to the United States

WHEN in 1776 our two countries parted company, the American people were on the threshold of a century of westward expansion. Of the details of that amazing story you have greater knowledge than I; but the main outline is there for all to see: the Louisiana Purchase, master stroke of the genius of Jefferson; the "Ohio fever"; the Mexican war; the Forty-Niners; the trek to Utah; and the innumerable unrecorded journeys of inconspicuous men and women.

So it went on, a great story of adventure, perseverance and dauntless daring; until those myriad human streams, trickling through valley, forest and prairie, at last reached the waters of the Pacific.

After 1776, we too entered upon a century of expansion. For us it was not a matter of crossing mountains and fording rivers. Your fathers lived on the fringe of an uncharted continent, ours in a small island. So when that same call of adventure came to us, as it came to you, making pilgrims of both our peoples, it led us overseas—to Canada, Australia, Africa, India, New Zealand—to almost every quarter of the globe.

There is a strong family likeness between these two movements. Both were, in the main, peaceful. They were not, as we know, accomplished without some fighting. You had the war with Mexico and the wars with the Indians. We too, throughout the nineteenth century, had our lesser wars in various parts of the world. But more important than any of these campaigns, was the long, almost uninterrupted process of peaceful expansion. In neither case, again, was this expansion planned. I suggest, subject to correction, that there never was a moment in American history when Congress, or the federal authority, or anyone else, sat down and plotted out a program of westward expansion, as business executives sit down to plan the expansion of a plant. It just happened. At one

time a great many people—in New England in particular—did not want it to happen. But it went on all the same because destiny is stronger than men or any government. And so it was with us. I can recall no occasion in all the nineteenth century when the rulers of Britain met in Westminster to discuss ways and means of enlarging the British Empire. The opposite was much nearer to the truth. Canada? There was a moment, rather earlier, it is true, than the time of which I am speaking, when the British government of the day seriously considered exchanging Canada for Guadeloupe, a vast territory for a tiny island. South Africa started off with a single port at which eastbound ships could load fresh vegetables. India? The records of the old East India Company are full of injunctions from the men in London to the men on the spot to keep clear of the country and its entangling quarrels and to mind their own business, which was trade. In different circumstances so it was in Australia, in New Zealand, in what are now the colonies of Africa, in Malaya, and everywhere else. The government proposed, destiny disposed. In the middle years of the last century many influential people were always urging that Britain should clear out of her overseas possessions. With the passing of the old colonial system and its monopoly of trade, colonies, as these outlying parts of the Empire were then all termed, were held by many to be unprofitable investments. They were judged a burden, an expense, a dangerous encumbrance.

But once again destiny was too strong.

Nor does that point of resemblance stand alone. There is a sense in which every one of your pioneers carried in his pack or his covered wagon a copy of the Declaration of Independence. By that I mean that, however far he traveled and in whatever loneliness he made his last camp, he held fast to a certain concept of man, and of what by God's grace man's life should be, and could be, in the great spaces of North America. And so he made his camp, his village, his town, his territory, and ultimately his state; each squarely founded upon that concept inherited from the Fathers of the Revolution. But it was older than those Fathers. In early colonial history it is recorded, I think of Massachusetts, that an elected assembly "broke out". It was not granted or decreed; it just appeared,

because it *had* to appear with that kind of people with that kind of background. Wherever they went, they began at once to reproduce, as though in obedience to a natural law, the things they had left behind them on the eastern side of the Atlantic—the common law of England, Magna Carta, habeas corpus, the jury system, the parliamentary tradition and the spirit of representative institutions. All these things, and much more, belong to you by right of birth as fully as they do to us.

On the British side of the picture the same design stands out. Through the nineteenth century the British Dominions were growing slowly into nationhood, until, in 1931, the Statute of Westminster recorded in law that independence which they had long enjoyed in fact. It is worth observing that because that great declaration of independence was not the result of a war, or three or four separate wars, and because the Dominions had not to fight for it, as you had to fight for it, but secured it by agreement, the world has not always taken full note of it. But the Statute of Westminster was no sudden thought; it was the climax to more than a century of political development and the logical end of a continuous process.

I have described it as a declaration of independence; but it was also a declaration of interdependence. And there may lie the germ of a new kind of relationship. Today it is scarcely necessary to argue about the dangers of unchecked nationalism or, for that matter, of unqualified isolationism—for you, for us, or for anyone else. For good or ill, we all live in a world that grows smaller every day. Nothing that happens in one part of it can fail to affect every other; and one of the morals we must surely draw from these days is that we live in one of the great formative times of human history, when the age of independence is yielding to the new conception of interdependence. If this be so, the value of this British experiment, however limited in its application, is obvious enough.

Limited though its application may have been, today we can hardly measure its consequences. In years to come it will surely seem a vital circumstance of history that the four great Dominions of the British Commonwealth, enjoying absolute independence, should have entered without delay or hesitation into a quarrel which some, unschooled in the idea of interdependence, might have thought remote from their shores and

alien to their interests. It is an event of history that in those dark days, when Europe shook with the rumble of Hitler's tanks and the tramp of German feet, from those four free corners of the world there should have instantaneously come that great and heartening reinforcement, of fighting men in all their vigor and valor, of food, of supplies, of help of every kind.

But let me carry my thought a little further. The democratic idea originated, as we all know, with the Greeks. Onto it was grafted the characteristically Anglo-Saxon institution of representative government. On that again you grafted the American conception of federalism, from which our Dominions have borrowed so freely and to such good purpose. From these two graftings, democratic government, which originally seemed only workable within the limits of a single city, became possible first in the small and composite nation-state, and then in far larger or more heterogeneous groups like the United States or Canada, or, as we hope, in India. It may therefore be that this later method of association, which we call the British Empire and Commonwealth, this method of combining complete freedom with the requisite unity in action, is the beginning of yet another grafting on the democratic plant.

Or we might look at it another way. The British Commonwealth resembles a crowd of widely assorted persons, linked together in one society, and all making the same journey. They started on it at different times. Some of them—Britain herself and the Dominions—have already reached the end of the journey, complete self-government. Others, like India, Burma and Ceylon, have nearly reached it, so nearly that there is only one more difficult stream to cross. Others have not got so far. But they are all moving, and all moving in the same direction. The road is not always smooth, and great stretches, as all know who have traveled it, are exposed to bleak winds and storms, that test all the traveler's faith. But two things will help men to their destination, however rough may be the world's weather in the time ahead. One is that they should appreciate the value of what lies at the road's end, which is freedom, and that they should so appreciate it as to recognize the dangers of short cuts, which might easily result in their losing the road altogether. And the other is that they should feel themselves members of a great and goodly company, who do value the same things and

who mean to hold fast their essential comradeship for the building of a better future for the human race.

When I hear criticisms of the British Empire or Commonwealth, they nearly always seem to be criticisms of the past rather than of the present. We all know that Queen Anne is dead. It is equally true that George III is dead. And if you will believe an Englishman who has tried to serve the colonies and India, no ghost of George III any longer haunts the Colonial Office, or the India Office. I am not suggesting that our record is a pattern of perfection. It is not. We have made plenty of mistakes. To few human beings is it given to avoid them. But I have no hesitation in asserting that, during at least the last half-century, we have tried always to apply two guiding principles in colonial government. The first is the principle of trusteeship; that we are where we are, not for our own profit, but for the good of the governed. The second, perhaps slightly younger in point of time, is the principle of progressive education in the business of self-government. I believe it also to be true of our application of both these principles that, as frequently happens in political experiments, more limelight is flashed on cases of success delayed than on those, here more numerous, of success achieved.

Such seem to me some of the grounds on which it is permissible to speak of parallel development of the United States and the British Commonwealth during the nineteenth century. And it is significant that that development was almost entirely free from foreign interference. That this was so was owing above all else to two forces, themselves not unconnected, the Monroe Doctrine and the British Fleet. Neither of these was an exclusive possession. The Monroe Doctrine was received as cordially in Britain as it was here. All students of history know that it originated in a suggestion made by George Canning, our Foreign Minister, to John Quincy Adams, Monroe's Secretary of State; and in those early days, at any rate, it had behind it, as an additional sanction, the unwritten guarantee of Britain. Not, let me hasten to add, out of pure philanthropy, because, while the British were anxious to thwart any enterprise which might extend the frontiers of reaction, the Doctrine, by securing the independence of South America, was also advantageous to British trade. In the same way, it was in no

narrow or national sense that the British Fleet interpreted its duties. Apart from being a visible discouragement of overseas adventures, it did much quiet police work which appears only in the footnotes of history books, if at all. Between 1815 and 1914 there were many wars, but they were not world wars. And it was by no chance that the first world war since the days of Napoleon occurred when a continental power set itself, for the first time in more than a hundred years, seriously to challenge the naval supremacy of Britain.

The Monroe Doctrine and the British Navy? Where do these guarantees of world peace stand today? Superficially their old connection might seem less direct. For behind the Monroe Doctrine is now plainly marshaled the whole strength of your great nation, organized, mobilized and intellectually alert to these great world issues as never before; and the American Continent can feel the more secure in that assurance. As to the British Navy, no one could have a higher admiration for it than I. Without it this war would have been lost as soon as it had begun. Yet none will question that in 1940 the British Navy could not, by itself, have saved our island from invasion and conquest. And that is surely one answer to my question. The air is transforming policy and strategy in every field, and as I have said the world grows smaller. If, therefore, we are serious in our determination to secure a lasting peace, we must satisfy ourselves that we have to our hand new guarantees that will secure it under the new conditions, not less effectively than we were on the whole able to do through the nineteenth century. That is a large question, on which, if I may, I would leave two thoughts only with you.

The first—and, as you have probably guessed, it arises out of the whole of my argument tonight—is that whatever the nations which want peace may together decide to do after the war in order to secure it—and we may all find rich hope in what has passed during these last days at Moscow—an indispensable part of any such larger plan must be the discovery of a firm basis for Anglo-American coöperation. And that, I venture to think, is as important for you as it is for us. During this past century we have worked together more often than the world realized; more often perhaps than we have always realized ourselves. But that largely unconscious coöperation

must, I have little doubt, now give place to something more definite and deliberate. And because I believe that fundamentally we want the same things—and that the things we both want are good things—we ought not to find that coöperation too difficult.

My second thought is this. You remember how Edith Cavell, when she was going out to face a German firing-party, said that patriotism was not enough. We had to have another war before we discovered the full truth of those words. Patriotism is a noble quality, but it is not enough. Independence is a generous ideal, but it is not enough. We may believe Empire or Commonwealth to be a beneficent force, but it is not enough. We are going to fail again, as we failed in 1918, if, as citizens of a tormented and war-wrecked world, we do not bring to its problems a new eye, a new mind, and a new heart—an eye to see, a mind to understand, and a heart to claim kinship with all men in all lands.

[The audience arose and applauded.]

CHAIRMAN DOUGLAS: I trust it is not unbecoming of me, sir, to attempt to express to you our gratitude for your appearance this evening. You have honored us by coming, not only because of what you have said, not only because of the high position you hold in our esteem and our affection, but because you are the representative of your country, of whom it can be said, I think, today, in a broader sense, what was said by Pitt when he received the news of the great victory of Trafalgar: "England has saved herself by her energy. May she save Europe by her example." [Applause]

And may I add the fervent hope that your people and our people, English-speaking people everywhere, will be clothed with the wisdom to cast aside our ancient prejudices and to fasten ourselves together so that, side by side, in company with other nations and other peoples cherishing the same ideals, dedicated to the preservation of the same things, we may at long last achieve an enduring peace. [Applause]

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